82-1869



No.

IN THE
# Supreme Court of the United States
October Term, 1982

MORRIS L. LEWY, et al.,
*Petitioners,*

vs.

WILLIAM B. WEINBERGER, et al.,
*Respondents.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

I. WALTON BADER
BADER AND BADER
*Attorneys for Petitioners*
65 Court Street
White Plains, N.Y. 10601
(914) 682-0072

Dick Bailey Printers, 203 Richmond Avenue ■ Staten Island, New York 10302
Tel.: (212) 447-5358 – (516) 222-2470 – (914) 682-0848

## QUESTIONS PRESENTED FOR REVIEW

1. May parties to a purported Class Action, which has not been certified by the Court as such, collusively agree to establish a "settlement class" for the purpose of settlement.

2. May parties to a purported Class Action, prior to any certification being made by the Court, agree to establish a settlement class and amend their complaint years after the filing thereof so as to destroy State Court Class Litigation which has been diligently prosecuted to arrive at a settlement in the Federal Action of about five-hundreths of a cent on the dollar of claims.

3. May a Federal Court grant pendent jurisdiction over purely state claims when the settlement class includes members who have no Federal Claims and whose claims are pending in State Court.

4. May a District Judge, in approving a settlement, avoid the requirements for a hearing, proper examination of the parties, and the normal requirements for approval upon the ground that a Bankruptcy Judge, in approving a settlement of $.21 on the dollar of bondholder claims, 400 times greater than the settlement arrived at in this case, has passed upon the issues involved making further consideration by the District Court unnecessary.

5. Where a District Court approves a Class Action settlement which destroys pending State Court Class Litigation is such action on the part of said Court in violation of the "Anti-Injunction Act."

6. Is there a conflict between the determination of the United States Court of Appeals for the Seventh Circuit in *In Re General Motors* and the determination of the United States Court of Appeals for the Second Circuit in this case.

7. In view of the fact that this Court has not yet passed on the validity of "opt out" requests or attorneys' fees to be awarded in this case is this action now "final" for the purpose of Supreme Court Review.

## TABLE OF CONTENTS

## TABLE OF CASES

## TABLE OF OTHER AUTHORITIES



## INDEX TO APPENDICES

# IN THE SUPREME COURT OF THE UNITED STATES

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MORRIS L. LEWY, MELVIN KIMMEL, HELEN SISK, MILDRED B. ANDERSON, GERALD J. ANDERSON, WALTER E. BARRIE, ANNE CRAWFORD, MALCOLM PINE, HERBERT LAPHAM, ARTHUR GARSON, and ANDRE R. JURKIEWICZ, and ARCHIE & ANNE PLESCIA individually and as representatives of Classes consisting of stockholders and bondholders of W.T. GRANT COMPANY,

*Petitioners,*

-against-

WILLIAM B. WEINBERGER, ROBERT SMITH, STEIN FAMILY FOUNDATION, INC., EDITH CITRON, LEO E. PANZIRER, and EMANUEL G. ROSENBLATT, JAMES C. KENDRICK, HARRY E. PIERSON, A. RICHARD BUTLER, ROBERT H. ANDERSON, JOHN E. SUNDMAN, ROBERT M. SCARLATA, JOSEPH W. CHINN, JR., RAYMOND H. FOGLER, JOSEPH HINSEY, JOHN G. GRAY, DEWITT PETERKIN, JR., LOUIS LUSTENBERGER, CHARLES PHILLIPS, ASA T. SPAULDING, C.W. SPANGLE, E. ROBERT KINSEY, RICHARD W. MAYER, MORGAN GUARANTY TRUST COMPANY OF NEW YORK, individually and as Agent for a Group of Twenty-Seven Lending Banks described herein, CHASE MANHATTAN BANK, N.A., CITIBANK, N.A., THE BANK OF NEW YORK, BANKERS TRUST COMPANY, CHEMICAL BANK, IRVING TRUST

COMPANY, MARINE MIDLAND BANK, SANWA BANK LTD., MANUFACTURERS HANOVER TRUST COMPANY, ERNST & ERNST, W.T. GRANT CO. and J.P. MORGAN & CO., INC.,

*Respondents.*

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioners herein pray that this Court grant a Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit. The grounds supporting this petition are set forth in full in the body thereof.

## LIST OF ALL PARTIES TO THIS PROCEEDING

In addition to the parties listed in the caption of this petition this appeal is being brought in behalf of a putative class of stockholders and debenture holders of WT GRANT COMPANY who have State Claims which are being prosecuted in pending State Litigation in the Courts of the State of New York. In addition, in the proceedings before the United States Court of Appeals for the Second Circuit, there were approximately four hundred fifty (450) individual parties who were objecting to the proposed settlement arrived at in the District Court.

## DECISIONS OF THE COURTS BELOW

See appendix. The District Court opinion was not officially reported. The opinion of the Court of Ap-

peals for the Second Circuit was reported at 698 F. 2nd 61.

## TIME PERIODS INVOLVED

As indicated in the Docket sheets submitted in the appendix to this Petition the original Order of the Court of Appeals for the Second Circuit was filed on July 4th, 1982 approving the proposed settlement. Petitions for Rehearing were thereafter filed by Appellants and others which were eventually granted by this Court. On January 26th, 1983 the Court essentially denied the Petition for Rehearing filed by certain appellants and on February 22nd, 1983 denied the Petition for Rehearing and Suggestion for Rehearing en banc filed by the Petitioners herein. This Petition for Certiorari is filed within 90 days from the date of such denial.

## JURISDICTION OF THIS COURT TO HEAR THIS PETITION

This Court acquires jurisdiction pursuant to 28 USC 1254(1).

## STATUTES, RULES AND OTHER MATTERS INVOLVED IN THIS PETITION

See appendix.

## TABLE OF CONTENTS AND TABLE OF OTHER AUTHORITIES

See the documents set forth *supra* in this petition.

## STATEMENT OF THE CASE

This is the first time that the approval by a Court of a settlement class (approved by the Court by agreement of the parties and not by adversary proceedings) has reached this Court for review. The practice was disapproved by the United States Court of Appeals for the Seventh Circuit in *In Re General Motors Engine Interchange Litigation*, 594 F.2nd 1106 (1979). It has been approved by various other Courts including, in this case, the United States Court of Appeals for the Second Circuit.

This is also the first time that a settlement has been approved, over objection by a substantial number of putative Class Members, without any efforts by the District Court or the Court of Appeals to determine the fairness and adequacy of the settlement. The District Court and the Court of Appeals merely adopted a determination made by a *Bankruptcy Judge* in another proceeding relating to the fairness and adequacy of a settlement of *bondholder* claims on *equitable subordination* grounds. Interestingly enough this settlement, which was obtained by counsel bringing on this petition, resulted not in a settlement of five-hundreths of a cent on the dollar of claims (as was involved in this case) but a settlement about 400 times greater (i.e. $.21 on the dollar of claims). The prior determination of the Bankruptcy Judge, of course, did not consider stockholder claims at all.

The parties have conceded, before both the District Court and the Court of Appeals, that the basis of the claims originally brought by the plaintiffs in this case was extremely weak and therefore the

miniscule settlement arrived at was justified. On the other hand the attorneys bringing on this matter, despite its conceded weaknesses, are seeking a handsome fee reward.

In fact, of course, as the fragmentary record in this case amply demonstrates, the State breach of fiduciary duty, conspiracy, and breach of trust claims were extremely strong. These claims were never interposed into this action until the State Court litigation was moving forward to trial and, at that time, were merely interposed into the case to destroy these claims for the benefit of the defendants and the plaintiffs' counsel.

This case amply demonstrates all of the criticisms that have been levelled at Class Actions by many parties. This Court should review the matter and set things right.

In 1975, by reason of the collapse of the WT GRANT COMPANY, there were two major Class Actions brought against the "creditor banks" who, through a high official of Morgan Guaranty Bank, one PETERKIN, were effectively in control of WT GRANT COMPANY. PETERKIN was also a director of WT GRANT COMPANY and in practical control of its policy making machinery.

The *Weinberger* action (brought by a "professional plaintiff" who has been involved in a myriad of Class Actions and probably has a close relationship with the plaintiffs' attorneys) was a Section 10(b) Securities Fraud Action. The State Litigation (the *Lewy* action) involved State Claims only and was primarily based on the fiduciary duties owned by a corporate management to creditors and stockholders

the "trust fund theory" relating to the assets of a corporation when the corporation is insolvent, conspiracy and fraud.

The defendants moved to dismiss the *Weinberger* complaint and, in January 1977 District Judge Duffy dismissed the complaint since it did not set forth viable claims. Leave to file an amended complaint was thereafter granted and an amended Complaint was filed on March 25th, 1977.

Thereafter, on April 4th, 1977 the *Weinberger* plaintiffs filed a motion for permission to file a Second Amended Complaint. This motion was made by reason of the fact the *Weinberger* plaintiffs became aware of the *Lewy* action and wished to "ride piggy back" on the Lewy allegations which constituted the heart of the claims against the creditor banks. The evidence clearly indicated that the Section 10-b securities claims were so weak as to be practically non-existent.

While the Second Amended complaint attempted to plead common law fraud under State Law the claims were not spelled out in detail and constituted a "broad brush" attempt to pre-empt the strong claims pending in *Lewy*. There were, in fact, no allegations in the said *Weinberger* second amended complaint which would be sufficient, either under federal or state law, to allege fraud.

Defendants thereafter moved to dismiss the Second Amended Complaint and, with respect to the defendant ERNST & ERNST, the complaint was, in fact, dismissed. The motion to dismiss by the creditor banks was held in abeyance by agreement of the parties.

In the meantime the *Lewy* action was proceeding apace. Therefore the defendant banks moved to stay this action on the ground that the Federal Action was all inclusive on the issues involved. The motion for a stay was denied on January 23rd, 1980 and was thereafter affirmed by the New York State Appellate Division of the Supreme Court.

Thereafter the plaintiffs in *Weinberger* and the defendant banks collusively decided to destroy the viability of the *Lewy* action by, in effect, "copying" the *Lewy* State Claims in a "Third Amended Complaint" in *Weinberger,* filing a Stipulation of Settlement and providing for a "settlement class" covering not only those plaintiffs who purchased Grant stock during the "Class Period" but also those plaintiffs who *held* such stock during the period even if they purchased earlier. This, of course, was completely at variance with the prior decisions of this Court and, in particular, *Blue Chip Stamps v. Manor Drugs Stores,* 421 US 723.

The District Court, without an evidentiary hearing, and over objections by parties adversely affected, approved the settlement involved. The determination was sustained by the Court of Appeals for the Second Circuit and the opinions of the Court involved are set forth in the appendix to this petition.

## REASONS WHY THIS PETITION SHOULD BE GRANTED

1. The Court of Appeals for the Second Circuit, in rendering the determination sought to be reviewed, has rendered a decision in conflict with a decision of the United States Court of Appeals for the Seventh

Circuit (*In Re General Motors Corp. Engine Interchange Litigation*, 594 F. 2nd 1106 (1979) and in conflict with another decision in the United States Court of Appeals for the Second Circuit *(National Super Spuds vs. New York Mercantile Exchange*, 660 F. 2nd 17 (1981). In *General Motors* the Court condemned settlement negotiations undertaken by a *putative* class representative who had not yet been certified as such. In *National Super Spuds*, the Court of Appeals for the Second Circuit refused to approve a settlement where a part of the certified class received nothing. Yet, in the present case, the United States Court of Appeals for the Second Circuit did precisely what was condemned in the prior opinions.

2. The Court of Appeals for the Second Circuit has decided this case in contravention of other decisions of this Court, in particular, *Blue Chip Stamps vs. Manor Drug Stores, supra, Protective Committee vs. Anderson* 390 US 414, *Santa Fe Industries vs. Green*, 430 US 462, *Cort vs. Ash*, 422 US 66, and *Piper vs. Chris-Craft Industries, Inc.*, 430 US 1 and taken jurisdiction of claims under State Law where no jurisdiction existed.

3. The Court of Appeals, in approving the settlement involved, has so far departed from proper practice as to require the exercise of this Court's supervision.

## POINT ONE

### MAY PARTIES TO A PURPORTED CLASS ACTION, WHICH HAS NOT BEEN CERTIFIED BY THE COURT AS SUCH, COLLUSIVELY AGREE TO ESTABLISH A "SETTLEMENT CLASS" FOR THE PURPOSE OF SETTLEMENT.

Rule 23, FRCP, requires that a Class be certified in a case "as soon as practicable after the commencement of an action brought as a class action." The Local Rules of many Courts, including the United States District Court for the Southern District of New York, require that a Class be certified within 60 days after the commencement of the action. These salutory rules are consistently flouted by collusive parties by entering into stipulations indefinitely extending the time for moving for Class Certification, then agreeing to a settlement, and certifying a Class, on consent, "for the purpose of settlement only."

This Court has not passed on this practice. It has been approved by many lower courts and specifically disapproved by the United States Court of Appeals for the Seventh Circuit. In so disapproving, in *General Motors, supra,* the Court, on page 1125 of the opinion, held as follows:

> "* * A person who unofficially represents the class during settlement negotiations must be under strong pressure to conform to the defendants' wishes . . . ***"
>
> * * *
>
> "* * Finally, unauthorized settlement negotiations deny other class counsel access to information about the negotiations which is helpful in evaluating the fairness of the settlement. * * *"

In the present case, while the *Weinberger* action was commenced in 1975, a Class was not certified until 1981, a period of six years.

Even after this long period of time, the Class was certified for the purposes of settlement only. Therefore, if the settlement were not had, or if the plaintiffs' counsel did not conform to the defendants' wishes, there would be no Class Certification.

In addition, in this case the defendants knew that there was another Class Action pending in State Court. In that action the State Claims were previously set forth. Contrary to the position of the plaintiffs in the Federal Class Action the Complaint, in the State Action, was *sustained* against attack. Thus conducting settlement negotiations with one set of attorneys to exclusion of the others is conduct to be condemned. (See *General Motors, supra.*)

Where Federal and State Class Actions are both pending, and particularly where the State Court has refused to stay the State Action, and where State Claims have not been involved in the Federal Action any settlement which excludes the State action is not proper under *General Motors.* Had the defendants been required to negotiate a settlement of both the Federal and State actions simultaneously the results would have been very different to the Class Members.

The action of the District Court, in approving a settlement arrived at between the Federal Class Counsel having a weak case without the simultaneous settlement of the State Action, is a violation of Rule 23(b)(3)(b) and Rule 23(b)(3)(C) which requires that, in determining the propriety of a Class Action, the Court must consider:

"* * the extent and nature of any litigation concerning the controversy already commenced by or against members of the Class. * * *"

and

"* * the desirability or undesirability of concentrating the litigation of the claims in the particular forum. * * *"

The exclusion of the State Court action from the proposed settlement and the Court's allowance of a "Third Amended Complaint" by agreement of the parties including the State Allegations when they had not been placed in the Federal Complaint heretofore and the Federal Action had been pending for years should simply not be permitted. The supervision of this Court so as to definitely forbid such practices is mandatory.

## POINT TWO

## MAY PARTIES TO A PURPORTED CLASS ACTION, YEARS AFTER FILING, AMEND THEIR COMPLAINT TO ENCOMPASS STATE CLAIMS WHICH HAVE BEEN HERETOFORE PROSECUTED IN STATE COURT AND THEN ENTER INTO A COLLUSIVE SETTLEMENT TO DESTROY THE STATE CLAIMS.

The parties in *Weinberger* are required to concede that the purported attempt to "copy" the State Claims set forth in *Lewy* without conducting any proceedings with respect to such claims, would normally be improper.

The sole justification for this practice, as set forth in the opinion of the Court of Appeals, is that the

State Claims were also weak and that, for this reason, the actions of the parties were not sufficiently gross to void the settlement arrived at.

The Court of Appeals relied, for this conclusion, on a decision of Bankruptcy Judge Galgay who, in the Bankruptcy Proceedings involving W T GRANT COMPANY, approved a settlement with *subordinated debenture holders* of $.21 on the dollar of claims.

This settlement, in the Bankruptcy Court, was negotiated principally by the attorneys filing this Petition and indicates to the Court what would have occurred had the settlement involved in this case been negotiated with State Court Counsel.

The Bankruptcy Settlement, of course, was negotiated purely for debenture holders and amounted to approximately 400 times the settlement arrived at in this case. It is also noteworthy that the settlement in this case, in effect, gives the debenture holders nothing because the settlement received in the Bankruptcy Proceeding is *deducted* from the settlement received in this case. Since the Bankruptcy Settlement amounted to $.21 on the dollar of claims the debenture holders are, in connection with this case, receiving nothing.

Quite obviously, a Court cannot deprive parties of their rights in another suit by taking over claims presented in that suit and then dismissing them.

Assuming, arguendo, that the Court had jurisdiction over the State Claims, (which is doubtful as will be set forth *infra* in this Petition), the general practice

is, of course, that a Court that first has jurisdiction of a controversy is entitled to proceed to a conclusion with respect to such controversy. Thus, for example, if a plaintiff brings an action in a State Court, and the defendant thereafter commences a similar action in Federal Court, the Federal Court will refuse to take jurisdiction of the second suit on the ground that another action is pending.

What the Court has done in this case is to stand the salutory doctrine preventing duplication of litigation and prevention of "forum shopping" on its head. If this settlement is permitted to stand the Court will have set forth a Rule to the effect that, once a federal suit is commenced, regardless of the weakness of the claims presented, the parties, by collusion, can destroy related State Litigation by simply copying the State Claims in the Federal Proceeding.

## POINT THREE

### MAY A FEDERAL COURT GRANT PENDENT JURISDICTION OVER PURELY STATE CLAIMS WHEN THE SETTLEMENT CLASS INCLUDES MEMBERS WHO HAVE NO FEDERAL CLAIMS AND WHOSE STATE CLAIMS ARE PENDING IN STATE COURT

Federal Courts are, by definition, Courts of limited jurisdiction. In order to prevent duplication of litigation a judge-made doctrine has developed known as pendent jurisdiction. Thus, if a Federal Claim is presented in a Federal Court, and a State Claim arises out of the same factual pattern, the Federal Court, as a matter of discretion only, may take pendent jurisdiction of the non-federal claims. However, if there is no

federal claim presented by a party, pendent jurisdiction is not available. (*United Mine Workers v. Gibbs,* 383 US 715 (1966).

In the present case since the Court certified a class of parties who purchased or *held* securities of WT GRANT COMPANY during the "Class Period," those security holders of W T GRANT COMPANY, who did not purchase their securities during the "Class Period" had no Federal Claims. Thus, in *Blue Chip Stamps vs. Manor Drug Stores,* 421 US 723, this Court, on pages 737 and 738 of the opinion, pointed out that the *Birnbaum Rule,* requiring a party to have purchased or sold a security during the appropriate period, was viable and affirmed. In its opinion this Court specifically held that *holders* of securities during the Class Period did not qualify as plaintiffs under Section 10(b) of the Securities Exchange Act, the Court stating as follows:

> "* * * Three principal classes of plaintiffs are presently barred by the *Birnbaum* Rule.
>
> * * *
>
> Second are actual shareholders of the issuer who allege that they decided not to sell their shares because of an unduly rosy representation or a failure to disclose unfavorable material. Third are shareholders, creditors, and perhaps others related to an issuer who suffered loss in the value of their investment due to corporate or insider activities. * *"

The Court, in *Blue Chip,* further points out that State remedies may be available for such parties but a federal remedy is not.

The Court of Appeals, in supporting the utilization of "pendent jurisdiction" to cover the claims of

the mere *holders* of said securities pointed out that the State and Federal claims had a common factual pattern. Even assuming that this was correct (which it is not) pendent jurisdiction is simply not available with respect to parties who have no federal claims. Thus, at least with respect to the putative class members who did not *purchase* their Grant securities during the "Class Period" the Court had no jurisdiction over them.

The grant of pendent jurisdiction over the debenture holders of Grant who are present holders thereof is likewise improper since these parties are receiving *nothing* in connection with the present settlement. Since the Bankruptcy Settlement of $.21 on the dollar of claims is about FOUR HUNDRED times more than the settlement in this case and the settlement provides that any amount awarded to the putative class members in the Bankruptcy Proceeding must be deducted from the amount to be awarded in this proceeding, these parties are receiving nothing. Thus the approval of the grant of pendent jurisdiction over these parties is in violation of a determination of the United States Court of Appeals for the Second Circuit in *National Super Spuds vs. New York Mercantile Exchange,* 660 F. 2nd 9 where the Court disapproved a settlement which had the effect of destroying State Claims of certain Class Members and awarded them nothing.

While the grant of pendent jurisdiction with respect to (1) those putative class members who merely *held* Grant securities during the "Class Period" and (2) the present holders of Grant debentures, was clearly improper the grant of pendent jurisdiction with respect to the remaining putative Class Members with

respect to State Claims was an abuse of discretion under the specific facts involved.

Since the State Claims were being dilligently prosecuted in State Court and an application to the State Court for a stay was denied and affirmed on appeal, the District Court, as a matter of discretion, abused such discretion by permitting pendent jurisdiction to be applied.

The petitioners submit that, where State Claims are first presented in State Court, a federal court has no power to grant pendent jurisdiction over these claims. While, this Court has not heretofore taken such a position it may very well desire to do so. However, it is submitted that under the specific facts of this case the Federal Court abused its discretion in granting pendent jurisdiction in this case.

In the first place this Court has held that claims for breach of fiduciary duties, breach of trust, and conspiracy are traditionally state remedies. Thus, where these claims are presented to a federal court, federal jurisdiction over them is uniformly denied. See, for example, *Santa Fe Industries vs. Green,* 430 US 462; *Cort vs. Ash,* 422 US 66 and *Piper vs. Chris-Craft Industries, Inc.,* 430 US 1.

There have been, of course, a number of cases where a Court has refused to grant pendent jurisdiction over State Claims where the "center of gravity" of the claims resides in State Court. See, for example, *Meyerhofer vs. Empire Fire & Marine Insurance Company,* 74 FRD 151 (Federal pendent jurisdiction denied over State Claims related to Federal Securities Claims).

In the present case, particularly because of the weakness of the Federal Claims presented, the District Court abused its discretion in granting pendent jurisdiction in this case.

## POINT FOUR

## THE SETTLEMENT INVOLVED HEREIN IS CLEARLY INADEQUATE

It has been conceded by all parties, in the prior proceedings in this case, that the amount of the present settlement is about $.05 on the dollar of claims. The settlement in the related Bankruptcy Proceeding (which is relied upon to sustain this settlement) is about four hundred times higher at $.21 on the dollar with this amount deducted from any amount to be received by the Class Members in connection with the present settlement.

The inadequacy of this settlement cries out for review. Why would present counsel bringing on this petition have received forty times more than the counsel supporting the present settlement. If, indeed, the Bankruptcy Proceedings and this proceeding are related, then is not the fact that the Bankruptcy proceedings resulted in a 400 times increase in settlement amount compared to the amount obtained in this proceeding, absolute proof of the inadequacy of the present settlement.

Courts have rejected settlements for inadequacy which have permitted a far greater recovery than the settlement in the present case. Thus in *Percondani vs. Riker-Maxon Corporation,* 50 FRD 473 the Court refused to permit a settlement to proceed which

granted the Class Members only 15% of the possible recovery. (Not one-half of one percent which the present settlement grants to the Class Members).

In *Weiss vs. Chalker,* 44 FRD 168 the Court required that further discovery be conducted before a settlement that could be inadequate was approved.

The State Law theory of the case (which was not considered by either the Bankruptcy Court or by the Courts below) involves the fiduciary duties that officers and directors of an insolvent corporation owe to stockholders and creditors thereof.

W T GRANT COMPANY was headquartered in New York and New York Law applies to this Company. In *Clarkson Co. vs. Shaheen,* 660 F. 2nd 506 (1981) the Court of Appeals for the Second Circuit set forth the New York Rule as follows:

> "* * If the corporation was insolvent at that time it is clear that defendants, as officers and directors thereof, were to be considered as though trustees of the property for the corporate beneficiaries * *"

See also *Ward vs. City Trust Co. of New York,* 192 NY 61 and *New York Credit Men's Adjustment Bureau, Inc. vs. Weiss,* 305 NY 1.

In the present case PETERKIN was the controlling director of W T GRANT COMPANY and also was an officer and director of the principal bank lender of W T GRANT COMPANY. While this company was insolvent he so manipulated the corporation so as to protect the position of the creditor banks and destroy the position of the stockholders and debenture holders of that corporation.

The "trust fund doctrine" set forth herein as applied under State Law is not the same as "equitable subordination" applied in a Bankruptcy Context. However the facts involved are of some import on the question of equitable subordination. This explains why the creditor banks were willing to pay about forty times more than in the present lawsuit to settle the Bankruptcy Proceedings. It also explains the desperation of the defendants to conclude a "sweetheart settlement" with the weak plaintiffs in *Weinberger* so as to destroy the strong viable claims pending in State Court in *Lewy*.

## POINT FIVE

## THE BANKRUPTCY DETERMINATION OF JUDGE GALGAY RELIED UPON BY THE COURT OF APPEALS TO SUSTAIN THE PRESENT SETTLEMENT IS NOT IN POINT

The Court of Appeals, in its opinion, admits that the District Judge did not conduct the required evidentiary proceedings necessary to approve a Class Settlement. However it relies on an opinion of Bankruptcy Judge Galgay which was rendered in the W T GRANT BANKRUPTCY PROCEEDINGS which approved a settlement of $.21 on the dollar of claims (not five-hundreths of a cent on the dollar of claims as involved in this case) for subordinated debenture holders based on theories of "equitable subordination."

That "equitable subordination" is a viable theory in Bankruptcy Proceedings is, of course, correct. See, for example, *Matter of Multiponics, Inc.* 622 F.2nd 709; *In Re American Lumber Co.*, 5 BR 470; *Pepper vs.*

*Litton*, 308 US 295 and *Geddes vs. Anaconda Mining Co.*, 254 US 590. Based on the factual pattern involved, and considering that a settlement of about 25% of the total claims was being presented, Bankruptcy Judge Galgay correctly held that the proposed settlement was approvable. Petitioners do not question Judge Galgay's approval of that settlement.

The rules, however, with respect to "equitable subordination" involve *discretionary* powers on the part of the Bankruptcy Judge. These rules, of course, do not apply to the violation of the fiduciary duties that officers and directors of a corporation owe to the *stockholders* thereof. Thus Judge Galgay did not consider the effect of stockholder claims.

Similarly Judge Galgay did not consider the effect of the questioned conduct under the New York "trust fund" rule. Thus, Judge Galgay did not consider whether W T GRANT was insolvent prior to the filing of the Petition in Bankruptcy nor a number of other questions which are germane to the imposition of liability upon the creditor banks under New York State Law in a plenary suit as opposed to claim priority questions under Bankruptcy Law. The only matter that Judge Galgay had before him was the relative priority between the subordinated debenture holders claims and the bank creditor claims. Breach of Fiduciary Duty claims, conspiracy claims and other State Claims were just not before him.

More importantly, of course, is the fact that Judge Galgay did not have any merit determination of the claims involved before him. In any event discretionary and mandatory liability is quite different.

Thus the matters before Judge Galgay were not material with respect to the approval or disapproval of the proposed settlement of this litigation.

The District Judge, since the State claims involved different theories than the claims for equitable subordination passed upon by Judge Galgay, could not avoid the requirements relating to settlement of class actions by merely relying on Judge Galgay's opinion.

Further confirmation of the above facts is found in the determination of the State Court which, in denying an application to stay the State Proceedings because of the pendency of the *Weinberger* litigation held that the *Weinberger* action and the Bankruptcy Proceedings were:

> "* * not so all-encompassing as to render certain that a settlement therein will necessarily obviate the tort claims before this Court * * *"

## POINT SIX

## THE APPROVAL OF THE SETTLEMENT HEREIN, COUPLED WITH THE PROHIBITION OF THE CONDUCT OF RELATED PROCEEDINGS IS A VIOLATION OF THE ANTI-INJUNCTION ACT

Congress, in its wisdom, in order to avoid unseemly conflicts between Federal and State Courts of coordinate jurisdiction has passed the "Anti-Injunction Act" 28 USC 2283 which provides, in pertinent part that:

> "* * A court of the United States may not grant an in-

junction to stay proceedings in a State Court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments. * * *"

The Act was passed to prevent defendants, who were subjected to proceedings in a forum not of their liking, to bring on some type of proceeding in a federal court and enjoin the State Proceedings.

In the case at Bar it is conceded that the State Claims involved were presented, for the first time, in the State Court and were only "copied" by the parties in *Weinberger* as part of the settlement objected to in this proceeding. Thus, in effect, the federal court has, as a practical matter, enjoined a State Proceeding and prevented the prosecution of State Claims in the forum where they were initially presented.

This is in clear violation of the Congressional intent in passing the "Anti-Injunction Statute" and should be reviewed by this Court.

## POINT SEVEN

### THE CASE IS BELIEVED TO BE FINAL FOR SUPREME COURT REVIEW EVEN THOUGH THE ATTORNEYS' FEES IN THIS CASE HAVE NOT YET BEEN FIXED OR THE VALIDITY OF CERTAIN PARTIES WHO HAVE "OPTED OUT" OF THE PRESENT SETTLEMENT, OF THEIR REQUESTS FOR EXCLUSION HAVE NOT YET BEEN PASSED ON BY THE COURT

In order to have this Court grant a Petition for a Writ of Certiorari the determination complained of

must be "final" and not subject to further review. In the present case, while the validity of the proposed settlement has been finally determined by the District Court and the Court of Appeals there are still other matters to be considered by the District Court in this matter.

There has been no determination as to the amount of fees to be awarded to the plaintiffs' attorneys if this settlement is approved and there is another proposed settlement to be considered by the District Court relating to claims against officers and directors of W T GRANT COMPANY.

Based on the decisional law (Cf. *City of New Orleans vs. Dukes,* 427 US 297 it would appear to the undersigned that this Petition is properly filed at this time.

However, in fairness to the Court, the finality question is being presented for the Court's consideration.

## CONCLUSION

**THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT SHOULD BE GRANTED.**

Respectfully submitted,

I. WALTON BADER
BADER AND BADER
Attorneys for Petitioners
65 Court Street
White Plains, NY 10601
914-682-0072

# OPINIONS OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AFFIRMING THE DETERMINATION OF THE DISTRICT COURT

*William B. WEINBERGER, et al.,*
*Plaintiffs-Appellees,*

*v.*

*James C. KENDRICK, et al.,*
*Defendants-Appellees,*

*Charles M. Coyne, et al., Appellants.*

*Nos. 956-959, Dockets 81-7317, 81-7629, 81-7827, 81-7829.*

United States Court of Appeals,
Second Circuit.

Argued April 19, 1982.

Decided July 14, 1982.

Order on Petitions for Rehearing
Jan. 26, 1983.

* * *

*20. Federal Civil Procedure 2737.5*

In view of fact that district court offered little by way of explanation for its attorneys' fee award and that scope of document was narrowed by telephone conversation and trial judge erroneously relied upon assumption that there were no objections to settlement in determining that issuance of subpoenas was improper, record failed to support finding that there

was clear evidence of bad faith or vexatiousness in issuing subpoenas which trial court described as "on their face, grossly overbroad," and sanction of fee award was not shown to be justified.

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Benedict Wolf and Lester L. Levy, New York City (Wolf, Popper, Ross, Wolf & Jones, and Wolf, Haldenstein, Adler, Freeman & Herz, New York City), for plaintiffs-appellees.

Philip C. Potter, Jr., Ogden N. Lewis and Denny Chin, New York City (Davis, Polk & Wardwell, New York City), for defendants-appellees.

Bradley R. Brewer, New York City (Brewer & Soeiro, New York City), for appellants Coyne, Collins and 580 other named appellants.

I.W. Bader, White Plains, N.Y. (Bader & Bader, White Plains, N.Y.), for appellants Lewy, Anderson, Barrie, Pine, Lapham, Garson, Howe, Barnes & Johnson and Jurkiewicz.

Before WATERMAN, FRIENDLY and MESKILL, Circuit Judges.

FRIENDLY, Circuit Judge:

These consolidated appeals are from a final judgment of Judge Duffy of the District Court for the Southern District of New York, entered on October 16, 1981, 91 F.R.D. 494, approving, pursuant to F.R. Civ.P. 23, the settlement of two securities class actions consolidated below—*Weinberger, et al. v. Kendrick, et al.*, and *Panzirer v. Peterkin, et al.* The complaints in these actions, filed on October 3, 1975, and

October 22, 1976, respectively, asserted claims on behalf of classes consisting of persons who had purchased securities of W.T. Grant Company (Grant) during the 34 months prior to that company's bankruptcy on October 2, 1975 (sometimes referred to hereafter as the class period). The defendants named in the actions were financial institutions (the banks) that loaned Grant more than $600 million prior to its bankruptcy,[1] and Dewitt Peterkin, Jr., a former vice-chairman of Morgan Guaranty and a Grant director. The complaints alleged that the defendants had dominated the management of Grant in the years preceding its bankruptcy and had concealed from the public both the seriousness of Grant's financial predicament and the inflated value of Grant securities. The plaintiffs asserted, among other things, claims against the defendant-appellees based on §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5, and common law fraud. The complaints in *Weinberger* and *Panzirer* were superseded by a consolidated amended complaint, filed July 25, 1980, along with the proposed settlement. In addition to the claims previously asserted, this advanced state law breach of fiduciary duty claims; the new complaint also expanded the plaintiff class to include persons who merely held Grant securities during the class period. The settlement approved by Judge Duffy would extinguish a number of these claims[2] in return for some $2.84 million,[3] which, after allowance of attorneys' fees, would be distributed to the plaintiff class. While no determination has been made how even the gross amount of the settlement compares to the amounts claimed, estimated by objectors' counsel as between $250 million and $1 billion, it is not disputed that the recovery will be only a negligible percentage of the

losses suffered by the class. Both the plaintiffs and the defendants below are here as appellees defending the settlement's adequacy.

The appellants are a number of persons who purchased or held Grant securities during the class period. One group, the Coyne appellants, allegedly 583 in number, represented by Bradley R. Brewer, fit the above description *simpliciter*. The other group, the Lewy appellants, are the eight named plaintiffs in a class action, Index No. 17857-75, filed in September 1975 in the Supreme Court of New York County which is now against three of the lending banks, Morgan Guaranty, Chase Manhattan and Citibank, asserting some of the claims asserted in the *Weinberger/Panzirer* actions but only under state law. Appellants raise a number of procedural and substantive challenges to the determination that the settlement is fair, reasonable and adequate. We affirm.

## I. Background

On October 2, 1975, Grant, with recorded liabilities of well over a billion dollars, filed a petition in bankruptcy court in the Southern District of New York for an arrangement under Chapter XI of the former Bankruptcy Act. Grant's petition came after two years of declining earnings and credit ratings. When the company's publicly reported earnings for the year ending January 31, 1974, declined by some $85,000,000, rating agencies downgraded Grant's commercial paper, thereby effectively denying the company access to the commercial paper market. As a result, in the spring of 1974, Grant began to obtain financing from commercial banks, first on an *ad hoc* basis with credit lines from numerous lenders

throughout the country, and later, in the fall of 1974, under a $600,000,000 committed revolving credit agreement arranged by the company's principal banks. Morgan Guaranty was the lead lender and acted as agent for the other banks, see note 1, *supra*. The revolving credit was secured by Grant's accounts receivable and certain securities it held in a subsidiary.

Despite the new credit, and various other steps taken by its lenders to ameliorate Grant's situation,[4] and contrary to rosy predictions by Grant's management, the company's financial position continued to deteriorate. The seriousness of this became fully apparent when an internal study ordered in the summer of 1975 by a new Grant president, Robert Anderson, was completed in late September: this revealed that the company had a negative net worth. The evidence indicates that the news came as a surprise to the banks and Grant's board. Grant's Chapter XI petition quickly followed.

Even more quickly came the first complaint in the *Weinberger* action, filed October 3, 1975. The complaint alleged that, as a result of their large loans, Grant's principal lenders had been in a position to, and in fact did, exercise considerable control over the management of the company in its final years. It further charged that the defendant banks and Grant's management had cooperated in presenting a misleadingly optimistic picture of the company's future to the public. The *Panzirer* complaint, filed on October 22, 1976, elaborated on this theme. It alleged that Peterkin became aware of Grant's true financial predicament in March, 1973, and passed this information to Morgan Guaranty, including the Trust and Investment Division, which thereafter sold virtually its

entire holding of Grant securities on the open market. Motions for class certification were filed in *Weinberger* in June, 1977, and in *Panzirer* in August, 1977; the motions were later adjourned during settlement discussions and were not renewed until agreement had been reached.

The development and settlement of the *Weinberger/Panzirer* action require an understanding of Grant's bankruptcy proceedings. Some six months after the filing of Grant's Chapter XI petition, the Bankruptcy Court, on April 13, 1976, determined that the company could not be reorganized and ordered its liquidation. On July 2, 1976, the principal banks commenced an adversary proceeding seeking enforcement of security interests they held in property of Grant's estate, see p. 64, *supra*. In his September 24, 1976, answer, the trustee in bankruptcy challenged these security interests on the grounds that they were preferential transfers and fraudulent conveyances; more important for our purposes, he also claimed that, because of the control they allegedly exercised over Grant's affairs during the years 1973-75, the company's principal lenders should be equitably subordinated[5] to other claimants.

In an effort to substantiate his charges, particularly his claim to equitable subordination, the trustee conducted investigations throughout the remainder of 1976 and 1977 into the relationship between Grant and its lenders during the class period. He relied principally on testimony taken under Bankruptcy Rule 205 and on documents subpoenaed from various parties.[6] Rule 205 examinations were taken of all the principal officers and directors of Grant, the principal officers at Morgan Guaranty responsible for dealings with Grant, and two officers of other major

lending banks. The testimony ran to some 10,000 pages. The trustee also subpoenaed those files of Grant's principal lenders which related to the company—comprising hundreds of thousands of documents.[7] In short, the trustee conducted a far-reaching and intensive probe of the banks' involvement in Grant's affairs during the class period.

Despite his extensive investigations, Grant's trustee concluded that his chances of proving any fraud or other wrongdoing by the lending banks were extremely slim, *cf.* 4 B.R. at 73-79 (Judge Galgay's approval of similar determinations by the trustee). Accordingly, he attempted, ultimately successfully, to settle the banks' claims. On February 24, 1978, the trustee and the banks entered into a settlement whereby the banks released their security interests in Grant's property in return for allowance of principal and interest on all prepetition loans which it was estimated would result in their receiving distributions of 55% or more of their claims, 4 B.R. at 59. The Bankruptcy Court, in a careful decision, 4 B.C.D. 597, issued on July 20, 1978, approved the settlement, and shortly thereafter the banks began receiving distributions. The appellees have averred that, despite the settlement, the banks will have lost more than $250,000,000 on their loans to Grant by the time the estate is fully liquidated.

Following approval of the settlement of the banks' claims, negotiations commenced regarding claims of holders of Grant's subordinated debt.[8] By April, 1979, an agreement had been reached and the trustee applied to the Bankruptcy Court for permission to offer the proposed settlement to holders of Grant's subordinated debt. On February 20, 1980, after six days of hearings on the proposed settlement,

including cross-examination of the trustee, his counsel, and his chief staff assistant regarding the fairness of the settlement, Judge Galgay, in a second lengthy decision, 4 B.R. 53, approved the settlement. He expressly found, among other things, that the banks' relationship with Grant during the class period had been one of "arms-length negotiations" and that Grant's actions "reflected independent policy decisions", 4 B.R. at 76-77. Eleven bondholders appealed this order to the District Court for the Southern District of New York (Conner, J.), which stayed consideration of the appeals so that Bankruptcy Judge Galgay could supervise continuing negotiations among the bankruptcy trustee, the indenture trustee, the banks, and the debentureholders for an improved offer to the latter. Counsel for the debentureholders who had appealed from the order approving the earlier offer stipulated that these appeals be withdrawn with prejudice, and this was so ordered. On June 23, 1981, an amended offer was approved by Judge Galgay. Two groups of debentureholders appealed to the District Court (Duffy, J.) from the order approving the amended offer. In an opinion and order dated March 15, 1982, Judge Duffy affirmed the order, 20 B.R. 186. He rested his decision primarily on the ground of *res judicata*, although he also stated that the appeals were without merit. Two groups of debentureholders have appealed to this court.

After agreement in principle was reached regarding the claims of Grant's major creditors, efforts focused, in the fall of 1979, on settling the *Weinberger* and *Panzirer* actions. Plaintiffs' counsel had engaged in a wide range of discovery during the four years prior to the commencement of settlement discussions. They had access to, and reviewed, both the bank documents subpoenaed by the trustee and the

testimony from the Rule 205 examinations he conducted. In addition, plaintiffs' counsel deposed several officers of Morgan Guaranty, paying particular attention to the relationship between that bank and Grant during the class period. Like Grant's trustee and Judge Galgay, however, plaintiffs' counsel found virtually nothing to substantiate their allegations against the banks: "[o]n the basis of all the evidence we were compelled to the conclusion that our chance of prevailing against the banks, while not nonexistent, was slim." With this in mind, and after rejecting as inadequate one settlement offer by the banks, plaintiffs' counsel agreed in late 1979 to the settlement of a number of the class action claims asserted in the *Weinberger/Panzirer* actions. An original settlement fund of $2.6 million agreed upon in May of 1980 was later increased to $2.84 million, which, with interest, now exceeds $3.5 million.

This proposed settlement was submitted to Judge Duffy for approval on July 25, 1980. It was accompanied by a consolidated amended complaint. Count I of the consolidated amended complaint, brought on behalf of all purchasers of Grant securities during the class period, alleged, as had the *Weinberger* complaint, that the banks "were in a position to, and did, control, influence and participate in Grant's operations, including the disclosure and nondisclosure of information relating to Grant's financial condition," ¶28, and that, using this control the banks "engaged in a scheme, plan and continuous course of conduct to present a falsely inflated and optimistic picture of Grant's . . . financial condition, and to conceal the true nature of Grant's operations and deteriorating financial condition from the investing public . . . " ¶30. It also asserted that the purchasers of Grant securities during the class period had relied in purchasing the

allegedly overvalued Grant securities upon false or misleading disclosures and nondisclosures resulting from the defendants' "course of conduct." Based on these allegations Count I of the complaint claimed violations of §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, ¶42, as well as of common law fraud principles, ¶44.

Count II of the consolidated amended complaint asserted claims on behalf of a broader class of plaintiffs. In addition to purchasers of Grant securities, the class included persons not previously included in either the *Panzirer* or *Weinberger* classes—persons who merely *held*, rather than *purchased*, Grant securities during the class period ¶48(B). In addition to alleging the claims described above under the federal securities laws, ¶49, the complaint charged that the defendants "have committed common law fraud and have breached their fiduciary duties to plaintiffs . . . ", ¶58, the latter theory not having previously been expressly advanced by plaintiffs. All these claims were based upon factual allegations almost identical to those underlying the federal securities law claims. The banks were charged with having "caused Grant to delay disclosing facts relating to the financial condition of Grant" and having caused Grant "to delay for their own benefit the filing of a petition in bankruptcy by Grant," ¶56.

Count III of the consolidated amended complaint, asserted on behalf of a class limited to purchasers of Grant common stock during the class period, alleged that Morgan Guaranty and Peterkin had violated Rule 10b-5 by engaging in insider trading during the class period. It also alleged that, during the class period, Morgan Guaranty was a controlling person of Grant under §20(a) of the Securities Exchange Act of 1934.

The proposed settlement agreement submitted to the district court along with the consolidated amended complaint, was accompanied by the parties' consent to the filing of the new complaint. In addition, the agreement requested the district court to enter an order determining, "for the purpose of effectuating the settlement" ¶8(a), that the action be maintained as a class action on behalf of the previously discussed classes of purchasers and holders of Grant securities. Substantively, the settlement agreement provided for the release of the above-described class claims asserted in the consolidated amended complaint, as well as any related claims arising out of the same transactions which might have been asserted, *cf.* note 2, *supra*, in return for the payment to the class of some $2.84 million.

Submitted to Judge Duffy on July 25, 1980, along with the consolidated amended complaint and the proposed settlement agreement, were notices of the pendency of class action, the class action determination, the proposed settlement and settlement hearing, which were to be mailed to prospective class members. These notices, among other things described the *Weinberger/Panzirer* action, set out the terms of the proposed settlement, defined the class that approval of the settlement would bind, and informed class members that they could opt out of the settlement, by so requesting before January 24, 1981,[9] or enter an appearance through counsel. Objections to the proposed settlement were required to be filed not later than two weeks before the scheduled February 18, 1982, fairness hearing; no deadline was set for submission of affidavits supporting the proposed settlement. Pursuant to the July 28, 1980, order of Judge Duffy, these notices were mailed to class members on December 9, 1980, and were published in the *Wall Street Journal*.

In a January 19, 1981, motion to vacate the July 25 order, counsel for appellants alleged that the settlement was inadequate and that the class notification procedure was defective in a number of respects. Judge Duffy denied the motion on February 6, 1981.

On February 17, 1981, the appellees filed papers supporting the settlement, including lengthy affidavits from counsel for both plaintiffs and defendants attesting to the fairness and adequacy of the settlement. Judge Duffy conducted the fairness hearing the next day; appellants tell us that this took no more than 10 minutes. At this hearing counsel for appellants submitted a memorandum requesting that the court treat their January 19 motion and certain letters counsel had written to the court as timely objections to the settlement. Judge Duffy refused to do so, although in his opinion approving the settlement, 91 F.R.D. at 495 n.3, he also rejected the objections as without merit. By May 19, 1981 the deadline for filing proofs of claim—some 26,000 claims had been filed.

[1] On August 13, 1981, Judge Duffy issued an opinion approving the proposed settlement as fair, reasonable and adequate. He found that "able and experienced" counsel for the class had conducted protracted arms-length negotiations in good faith; that "extensive" pre-trial discovery had enabled the parties to "fully . . . evaluate the strengths and weaknesses of the class claims"; that both he and the parties properly could rely on factual and legal findings made by Bankruptcy Judge Galgay, *In re W. T. Grant Co.*, 4 B.R. 53 (Bkrtcy. S.D.N.Y. 1980), which dealt with the circumstances underlying the settlement and which indicated that the plaintiffs' "chances of prevailing were slim"; that the plaintiffs' claims were "complex" and "not easily proven," particularly

in view of the "heavy burdens of proof" faced by plaintiffs and "vigorous defenses" asserted by defendants; and that a trial would inevitably involve "lengthy and costly litigation." He concluded that, "[i]n view of the difficulties plaintiffs would confront if this case went to trial, the recommendation of experienced counsel and the lack of individual objections to the settlement, I find that the sum offered by the defendants is acceptable." The opinion did not discuss most of the procedural objections considered in this opinion, perhaps because of the judge's findings that no timely objections were filed.[10]

## II. DISCUSSION

*A. The Class Notice*

[2] We deal first with appellants' numerous challenges to the notice of class action and proposed settlement mailed to prospective class members on December 9, 1980. Appellants initially argue that the notice failed adequately to describe the proposed settlement. They also contend that it should have contained a wide variety of additional information more fully describing the terms of the proposed settlement and the manner in which the negotiations leading to it had been conducted.[11]

Although no rigid standards govern the contents of notice to class members, *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S.Ct. 652, 657, 94 L.Ed. 865 (1950), the notice must "fairly apprise the prospective members of the class of the terms of the proposed settlement and of the options that are open to them in connection with [the] proceedings," *Grunin v. International House of Pancakes*, 513 F.2d 114, 122 (8 Cir.), *cert. denied*, 423 U.S.

864, 96 S. Ct. 124, 46 L.Ed.2d 93 (1975), *quoting Philadelphia Housing Authority v. American Radiator & Standard Sanitary Corp.*, 323 F. Supp. 364, 378 (E.D. Pa. 1970), *aff'd sub nom., Ace Heating & Plumbing Co. v. Crane Co.*, 453 F.2d 30 (3 Cir. 1971); See *Mullane v. Central Hanover Bank & Trust Co., supra*, 339 U.S. at 314, 70 S. Ct. at 657, and it must be neutral, see *Grunin, supra*, 513 F.2d at 122. Numerous decisions, no doubt recognizing that notices to class members can practicably contain only a limited amount of information, have approved "very general description[s] of the proposed settlement," *Grunin v. International House of Pancakes, supra*, 513 F.2d at 122. See *In re Equity Funding Corp. of America Securities Litigation*, 603 F.2d 1353, 1361-62 (9 Cir. 1979); *Mendoza v. United States*, 623 F.2d 1338, 1351-52 (9 Cir. 1980), *cert. denied*, 450 U.S. 912, 101 S. Ct. 1351, 67 L.Ed. 2d 336 (1981), *In re Corrugated Container Antitrust Litigation*, 643 F.2d 195, 223-24 (5 Cir. 1981).

[3] The December 9, 1980, class action notice, met the foregoing requirements. It fairly, accurately and neutrally described the claims and parties in the Weinberger/Panzirer litigation, as well as the terms of the proposed settlement and the identity of persons entitled to participate in it. The notice described in detail a related state court action—*Lewy v. The Chase Manhattan Bank, N.A., et al.*, App. Div. 437 N.Y.S.2d 263—brought by counsel for the appellants.[12] It explicitly informed class members that "[p]articipation in the present settlement would preclude any participation in the *Lewy* case." The notice also explained that class members could exclude themselves from the settlement by requesting this prior to January 24, 1981, or could enter an appearance at the fairness hearing through counsel. Finally, it informed the class

that the recovery would be subject to the district court's allowance of attorney's fees and expenses and that counsel expected to apply for fees not exceeding 25% of the settlement fund. There is little question that all this "fairly apprise[d]" prospective class members of the class action's pendency, the relevant terms of the proposed settlement, and their options in connection with that case. Those who wanted to probe more deeply could, as the notice plainly told them, examine "[t]he settlement stipulation and the papers and documents filed in this action . . . "[13]

[4] Appellants next contend that the mailing of individual notices to the last known addresses of all class members, as determined from the records of Grant and various brokerage houses and nominees, was inadequate since the addresses of many securityholders might have changed during the period since Grant's bankruptcy. Feeral Rule of Civil Procedure 23(c)(2)[14] and *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 176, 94 S Ct. 2140, 2151, 40 L.Ed.2d 732 (1974), require only that "each class member who can be identified through *reasonable effort*" (emphasis added), be notified. In *In re Franklin National Bank Securities Litigation*, 574 F.2d 662, *modified*, 599 F.2d 1109 (1978), we discussed the application of the *Eisen* requirement to classes consisting of purchasers of securities, noting the difficulty of ensuring that notice is received by persons whose purchases are recorded in "street names"—typically banks or brokerage houses. We disapproved the practice of sending class notices to street name addresses with a request that the recipient forward the notice to the beneficial holder of the securities but without an offer to defray the resulting expenses, 574 F.2d at 669-70. We indicated approval, however, of the use of bank and brokerage house records to compile a list of actual

holders of securities to whom individual notices would be mailed, 574 F.2d at 672. Here appellees compiled such a list, mailed individual notices, and, in addition, published notice of the class action and settlement in the *Wall Street Journal.* Some 26,000 proofs of claim have been filed as a result of these notice procedures. The district court, in its July 28, 1980, order, expressly found this procedure adequate and we see no reason to disturb its finding, particularly since no alternative method of ascertaining class members' identities has been suggested to us, see *Grunin v. International House of Pancakes, supra,* 513 F.2d at 121-22 (individual mailing to last known address, without supplemental newspaper publication, approved, despite evidence that one third of prospective class did not receive notices).

[5, 6] Likewise, the timing of the notices, which were mailed on December 9, 1980; the opt-out deadline, January 24, 1981; the deadline for the filing of objections, February 4; the date affidavits in support of the settlement were filed, February 17; and the fairness hearing, February 18, were not beyond the authority of the Court. According to the Professor Moore, "[t]he manner of giving notice is committed to the sound discretion of the court," 3B Moore's Federal Practice ¶23.80[3], at 23-513 (1982), as is suggested by Rule 23's statement that notice of settlement shall be "in such manner as the court directs." The notice, however, must be "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections," *Mullane v. Central Hanover Bank & Trust Co., supra,* 339 U.S. at 314, 70 S. Ct. at 657, and it must "afford a reasonable time for those interested to make their appearance,"

*Id.* Prospective class members had some six weeks in which to decide whether or not to accept the settlement. Although we think it would have been preferable if appellees' affidavits and other papers in support of the settlement had been required to be available at a date earlier than the eve of the hearing, the failure of the district court to demand this does not require reversal. Objectors were fully apprised of the terms of the proposed settlement and, although they did not avail themselves of the opportunity, had complete access to materials discovered in the case; this provided an adequate base from which objections could be developed. See 3 Newberg, Class Actions §5660d (1977). The requirement, challenged by appellants, that requests to opt-out be filed prior to the fairness hearing placed prospective objectors in no worse position than occurs when formal class certification precedes settlement; indeed, their position was better in that they knew the terms of the proposed settlement before having to decide whether to opt out.

Appellant's final procedural objections relate to appellees' having engaged in and concluded settlement negotiations prior to class certification and notice. Closely related to this, they challenge the simultaneous notification of class members of the class determination (for purposes of settlement) and the proposed settlement. We shall discuss this initially as if the class certification related solely to the class named in the earlier *Weinberger/Panzirer* complaints, i.e., claims arising from the purchase of Grant securities during the class period, and will deal later with the added problems arising from the inclusion of other claims.

In *In re Franklin National Bank Securities Litigation, supra,* 574 F.2d at 671-72 n.6, we questioned in dictum the practice of bypassing the formal class certification procedure and of sending simultaneous notice of the pendency of a class action and of a proposed settlement to prospective class members. We voiced concern that the praactice might be "inconsistent with the requirement [of Rule 23] that certification as a class action be determined 'as soon as practicable after the commencement of the action' and the implication that the initial class notice should follow promptly after the certification," *id.,* and said that "[s]o far as we are aware the only cases in which this question has been specifically passed upon have held that the sending of the initial class notice should not be postponed," *id.* Our hesitation to approve the practice echoed the concerns expressed in the *Manual for Complex Litigation* §1.46, at 60-61 (1977) (*Manual*), which argues that the practice may create the possibility of collusion or improper pressure by defendants on "unofficial" counsel for the class. The *Manual* recommends a firm prophylactic rule prohibiting the bypassing of an early formal class certification and the formation of temporary classes for settlement purposes.

Despite the *Manual's* concerns and the misgivings expressed in the *Franklin National Bank* footnote, we concluded in *Plummer v. Chemical National Bank,* 668 F.2d 654, 656 (2 Cir. 1982), that "[a]lthough negotiations in the instant case were conducted by undesignated class representatives without pretrial discovery, this, standing alone, did not preclude judicial approval," 668 F.2d at 658. See also *City of Detroit v. Grinnell Corp.,* 495 F.2d 448, 464-66 (2 Cir. 1974). A similar view is taken in Judge Wisdom's

thorough opinion in *In re Beef Industry Antitrust Litigation*, 607 F.2d 167, 173-78 (5 Cir. 1979), *cert. denied*, 452 U.S. 905, 101 S. Ct. 3029, 69 L.Ed.2d 405 (1981), which carefully reviews the authorities and commentary on the question. Much like our decision in *Plummer v. Chemical Bank*, the Fifth Circuit concluded that:

> A blanket rule prohibiting the use of temporary settlement classes may render it virtually impossible for the parties to compromise class issues and reach a proposed class settlement before a class certification. Such a firm restriction does not appear necessary or desirable. The hallmark of Rule 23 is the flexibility it affords to the courts to utilize the class device in a particular case to best serve the ends of justice for the affected parties and to promote judicial efficiencies.
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> Temporary settlement classes have proved to be quite useful in resolving major class action disputes. While their use may still be controversial, most courts have recognized their utility and have authorized the parties to seek to compromise their differences, including class action issues, through this means.

*In re: Beef Industry Antitrust Litigation, supra*, 607 F.2d at 177-78, *quoting* 3 Newberg, Class Actions §5570c, at 479-80 (1977).

Other circuits have held that the absence of class certification prior to the notice of the settlement is not an absolute bar to approval. See *Ace Heating & Plumbing Co. v. Crane Co., supra*, 453 F.2d at 33; *In re Corrugated Container Antitrust Litigation, supra*, 643 F.2d at 223 ("Rule 23 includes no language proscribing combined notice of a class action and a proposed settlement."); *Marshall v. Holiday Magic, Inc.*, 550

F.2d 1173, 1176 (9 Cir. 1977); *Valerio v. Boise Cascade Corp.*, 80 F.R.D. 626, 639 (N.D.Cal.1978), *aff'd*, 645 F.2d 699 (9 Cir. 1981), *cert. denied*, 454 U.S. 1126, 102 S.Ct. 976, 71 L.Ed.2d 113 (1981).

[7] Although we thus refuse to adopt a *per se* rule prohibiting approval when a class action settlement has been reached by means of settlement classes certified after the settlement, with notice simultaneous with that of the settlement, we emphasize that we are permitting, not requiring, use of this procedure, and also underscore that, as intimated by us in *Plummer, supra*, 668 F.2d at 658, district judges who decide to employ such a procedure are bound to scrutinize the fairness of the settlement agreement with even more than the usual care. This is necessary in order to meet the concerns, noted in the *Manual*, regarding the possibilities of collusion or of undue pressure by the defendants on would-be class representatives. Accordingly, we will demand a clearer showing of a settlement's fairness, reasonableness and adequacy and the propriety of the negotiations leading to it in such cases than where a class has been certified and class representatives have been recognized at an earlier date. As discussed below, we are satisfied that the settlement in this case meets these requirements.

B. *The Fairness, Reasonableness and Adequacy of the Proposed Settlement*

[8] The central question raised by the proposed settlement of a class action is whether the compromise is fair, reasonable and adequate. There are weighty justifications, such as the reduction of litigation and related expenses, for the general policy favoring the settlement of litigation, 3 Newberg, Class Ac-

tions §5570c, at 479-80 (1977); cf. *Williams v. First National Bank*, 216 U.S. 582, 595, 30 S.Ct. 441, 445, 54 L.Ed. 625 (1910). In part to realize these advantages of settlements negotiated by litigants, we have long recognized that a district court's disposition of a proposed class action settlement should be accorded considerable deference, *West Virginia v. Chas. Pfizer & Co.*, 440 F.2d 1079, 1085 (2 Cir.), *cert. denied sub nom. Cotler Drugs, Inc. v. Chas. Pfizer & Co.*, 404 U.S. 871, 92 S.Ct. 81, 30 L.Ed.2d 115 (1971); *Newman v. Stein*, 464 F.2d 689, 692 (2 Cir.), *cert. denied sub nom., Benson v. Newman*, 409 U.S. 1039, 93 S.Ct. 521, 34 L.Ed.2d 488 (1972); *City of Detroit v. Grinnell Corp., supra*, 495 F.2d at 454-55 (2 Cir. 1974); *Patterson v. Newspaper & Mail Delivery Union*, 514 F.2d 767, 771 (2 Cir. 1975). The trial judge "is exposed to the litigants, and their strategies, positions and proof. He is aware of the expense and possible legal bars to success. Simply stated, he is on the firing line and can evaluate the action accordingly." *Ace Heating & Plumbing Co. v. Crane Co., supra*, 453 F.2d at 34. While this principle does not apply in full force when settlement of a class action has been negotiated before a class has been certified and a higher degree of judicial scrutiny is required, particularly when, as here, there is nothing to indicate that the district judge felt compelled to do this, it is not wholly deprived of force.

[9] Determination whether a proposed class action settlement is fair, reasonable and adequate involves consideration of two types of evidence. The primary concern is with the substantive terms of the settlement: "Basic to this . . . is the need to compare the terms of the compromise with the likely rewards of litigation." *Protective Committee for Independent*

*Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424-25, 88 S.Ct. 1157, 1163, 20 L.Ed.2d 1 (1968). See also *Newman v. Stein, supra*, 464 F.2d 689; *City of Detroit v. Grinnell Corp., supra*, 495 F.2d at 455. In order to make this comparison, the trial judge must "apprise[ ] himself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated." *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson, supra*, 390 U.S. at 424, 88 S.Ct. at 1163. However, "all" cannot really mean "all". The Supreme Court could not have intended that, in order to avoid a trial, the judge must in effect conduct one. *Saylor v. Lindsley, supra*, 456 F.2d at 904; *Newman v. Stein, supra*, 464 F.2d at 691-92; *City of Detroit v. Grinnell Corp., supra*, 495 F.2d at 462. In order to supplement the thus necessarily limited examination of the settlement's substantive terms, attention also has been paid to the negotiating process by which the settlement was reached, and courts have demanded that the compromise be the result of arm's-length negotiations and that plaintiffs' counsel have possessed the experience and ability, and have engaged in the discovery, necessary to effective representation of the class's interests, *City of Detroit v. Grinnell Corp., supra*, 495 F.2d at 463-66.

[10] The appellants, citing *Protective Committee v. Anderson, supra*, argue at great length that the lower court's two page opinion demonstrates that it did not adequately scrutinize either the substantive terms of the proposed settlement or the propriety of the process of negotiations. We see nothing in the latter point. The district court noted the absence of any indication of collusion, the protracted settlement negotiations, the ability and experience of plaintiffs'

counsel, the extensive discovery preceding settlement and the fact that counsel for all parties—including the objectors—had access to materials produced in discovery, including the extensive and detailed discovery of Grant's trustee, who commanded financial resources and professional assistance, see note 6, *supra*, not always available to plaintiffs' counsel in class actions. All these considerations, as previous decisions have noted, *City of Detroit v. Grinnell Corp., supra*, 495 F.2d at 465; *In re Beef Industry Antitrust Litigation, supra*, 607 F.2d at 176; *Plummer v. Chemical Bank, supra*, 668 F.2d at 658, are important indicia of the propriety of settlement negotiations. Indeed, as discussed more fully below, plaintiffs' presettlement preparation and discovery efforts in this case were substantially more thorough than those in many other decisions where settlements have been approved.

We are almost equally confident as regards the substantive terms of the proposed settlement. Although the district court's discussion of this was rather cursory, our own examination of the record leads us to conclude that the court had before it sufficient materials to evaluate the settlement and came to the correct conclusion.

Both the defendants and plaintiffs in *Weinberger/Panzirer* submitted lengthy affidavits to the district court. These carefully described the history of the litigation and, more important, thoroughly canvassed the evidence, both that supporting and that refuting plaintiffs' claims. As noted above, this evidence included the materials amassed in the trustee's investigation. Since his claim of equitable subordination required a detailed inquiry into the relationship between the banks and Grant,

which is precisely the issue raised in the *Weinberger/Panzirer* actions, his discovery efforts were extremely relevant to the plaintiffs' claims. The lower court also had the unusual and important benefit of several careful and well-reasoned opinions by Bankruptcy Judge Galgay, see pp. 7-8, *supra*. These opinions, particularly as they related to the equitable subordination question, provided excellent guidance from a disinterested source on questions central to the fairness and adequacy of the proposed settlement. Taken together, these materials provided a satisfactory record on which the district court could base its decision.

Moreover, from what we have distilled from the record, we think the district court's decision met the higher standard of scrutiny we believe appropriate in this case. As plaintiffs' counsel observed, "[i]n weighing the class' chance of prevailing on the merits in the case against the banks it was . . . important to differentiate between proving the liability of a bankrupt Grant to the class and proving any liability on the part of the defendant banks, who themselves lost hundreds of millions of dollars by reason of their transactions with Grant during the class period." Levy Affidavit ¶59. Central to plaintiffs' claims against the banks under both the federal securities laws and the common law was the allegation that the defendants "were in a position to, and did, control, influence and participate in Grant's operations." Consolidated Amended Complaint ¶28. This precise point had been considered by Judge Galgay in Grant's bankruptcy proceedings. He said:

> I am satisfied that in the case of Grant the transactions between the Bank Claimants and Grant are the result of arms-length negotiations conducted in

good faith and governed by the dictates of sound business judgment. I have reviewed the evidence and, in particular, the portions of testimony elicited in examinations pursuant to Bankruptcy Rule 205(a) which the [objectants] claim establish control and domination on the part of the Bank Claimants. The excerpts referred to by the [objectants] constitute but a small portion of the vast amount of information, facts and materials considered by the Trustee. To a considerable extent, the "facts" presented by the [objectants] are based upon hearsay testimony, distortions of testimony, out-of-context statements or misstatements.

The record establishes the converse. It appears that the action taken by Grant reflected independent policy decisions and not rigid submission to the dictates of the Bank Claimants. Mr. Sundman, a chief financial officer of Grant who had been appointed a director in 1974, testified that he operated without instructions from the Bank Claimants and that the advisory group organized by the Bank Claimants in 1974 offered neither suggestions nor opinions as to the business operations of Grant. There has been no evidence introduced by the [objectants] which would tend to establish that the Bank Claimants prevented Grant from initiating a proceeding under the Bankruptcy Act in 1974 or 1975. The record demonstrates that prior to the decision made by the Grant Baord of Directors during the end of September 1975 to seek relief under the Bankruptcy Act, both the Bank Claimants and Grant management viewed Grant as a turnaround situation and not insolvent.

Accordingly, it must be concluded that the probabilities of success as to the prosecution of claims of equitable subordination are very remote. In that context, the Trustee's recommendation is well founded.

4 B.R. at 76-77 (footnote omitted).

Likewise the affidavit of plaintiffs' counsel described the uncontradicted deposition statements of various officers of Morgan Guaranty to the effect that the bank was "not capable or desirous of making management decisions and did not attempt to tell Grant how to run its business."

The evidence adduced in discovery had also failed to support plaintiffs' claims in other respects. Counsel for the plaintiffs averred that the evidence indicated that "the banks themselves were misled by Grant's management's statements and projections that the fortunes of Grant would recover." Levy Affidavit ¶56. The allegation, advanced in the *Panzirer* action, and Count III of the consolidated amended complaint, that Morgan Guaranty's Trust and Investment Division had sold approximately one million shares of Grant common stock in 1973 based on inside information obtained from Peterkin regarding Grant's financial condition, was also belied by the evidence. Peterkin testified that in 1973 he had not foreseen Grant's later troubles. Harrison U. Smith, Vice-Chairman of Morgan Guaranty's Trust and Investment Committee, testified that the decision to sell Grant securities had been reached in 1972 and that no discussions with Peterkin had occurred. Plaintiffs' counsel frankly conceded, "[w]e do not have any hard evidence to contradict Smith" and admitted that the fact that Morgan commenced selling Grant shares in 1972 severely cut against his case.

We should thus have no difficulty in affirming the approval of the settlement were it not for appellants' contentions based on the inclusion in the consolidated

amended complaint and thus in the settlement of "state law" claims arising from the purchase of Grant securities prior to the "class period" but held into or beyond the period—a subject to which we now turn.

C. *The Inclusion of Claims Arising Out of the Mere Holding of Grant Securities*

[11,12] So far as concerns a class member who had purchased Grant securities prior to and during the class period, the court clearly had jurisdiction to entertain the claims arising from mere holding as well as those arising from purchase as a matter of pendent jurisdiction. The requirement of *United Mine Workers v. Gibbs,* 383 U.S 715, 725, 86 S.Ct. 1130, 1138, 16 L.Ed.2d 218 (1966), that federal and state claims share a "common nucleus of operative fact" before the doctrine may apply is satisfied, as our discussion of the similarities between the rule 10b-5 and the state common law claims, pp. 31-35, *infra,* demonstrates. Likewise, there is no question that plaintiffs' Rule 10b-5 claims are constitutionally "substantial". The requirement of "an examination of the posture in which the non-federal claim is asserted and of the specific statute that confers jurisdiction over the federal claim, in order to determine whether 'Congress . . . has . . . expressly or by implication negated' the exercise of jurisdiction over the particular nonfederal claim," *Owen Equipment & Erection Co. v. Kroger,* 437 U.S. 365, 373, 98 S.Ct. 2396, 2402, 57 L.Ed.2d 274 (1978), is readily met since the Securities Exchange Act's conferal of exclusive jurisdiction on federal courts, §27, for violations of that act permits adjudication of all related claims only in those courts, see *International Controls Corp. v. Vesco,* 593 F.2d 166, 175 n.5 (2 Cir.), *cert. denied,* 442 U.S. 941, 99 S.Ct. 2884, 61 L.Ed.2d 311 (1979).

[13] A more difficult jurisdictional question would be raised by the inclusion of persons having only claims arising from purchases prior to the class period, if such there be. Such a person would lack the federal claim necessary as a predicate to pendent jurisdiction; federal jurisdiction with respect to him seemingly would have to rest on the notion that when there is federal jurisdiction over the claims of many parties having both federal and state claims with a common nucleus of law and fact, a federal court, in the exercise of sound discretion, may also join as plaintiffs persons holding only state claims having such a nexus.

The law on this subject, including the Supreme Court's decision in *Aldinger v. Howard*, 427 U.S. 1, 96 S.Ct. 2413, 49 L.Ed.2d 276 (1976), is fully discussed in 3A Moore, Federal Practice ¶20.07 [5.-1]-[5.-3] (1982). Although the *Aldinger* Court disapproved of the joinder of a pendent party defendant in the case before it, the Court explicitly limited its conclusion to "the issue of so-called 'pendent party' jurisdiction with respect to a claim brought under [28 U.S.C.] §§1343(3) and [42 U.S.C.] 1983", *id.* at 18, 96 S.Ct. at 2422, and noted that "[o]ther statutory grants and other alignments of parties and claims might call for a different result," *id.*, and that "it would be as unwise as it would be unnecessary to lay down any sweeping pronouncement upon the existence or exercise of such jurisdiction", *id.*

The circumstances here are about as powerful for the exercise of pendent party jurisdiction as can be imagined. The exclusivity of federal jurisdiction over claims for violation of the Securities Exchange Act makes a federal court the only one where a complete

disposition of federal and related state claims can be rendered. Cf. the Court's comment in *Aldinger* that "[w]hen the grant of jurisdiction to a federal court is exclusive, for example, as in the prosecution of tort claims against the United States under 28 U.S.C. §1346, the argument of judicial economy and convenience can be coupled with the additional argument that *only* in federal court may all of the claims be tried together," 427 U.S. at 18, 96 S.Ct. at 2422. The concern most frequently voiced with regard to the pendent party doctrine is that it requires a party not otherwise subject to suit in federal court to defend himself in that forum, see *Aldinger v. Howard, supra*, 427 U.S. at 18, 96 S.Ct. at 2422. In this case pendent party jurisdiction serves, see *Almenares v. Wyman*, 453 F.2d 1075, 1084-85 (2 Cir. 1971), *cert. denied*, 405 U.S. 944, 92 S.Ct. 962, 30 L.Ed.2d 815 (1972), to extend federal jurisdiction to a new group of *plaintiffs*. Pursuant to the opt-out procedures established by the district court, plaintiffs who did not wish to have their claim settled in a federal forum and in fact received notice of the settlement needed only to request exclusion. Finally, the state law claims asserted on behalf of the pendent plaintiffs are already before the federal courts, having been asserted on behalf of persons who purchased Grant securities during the class period.[15]

Appellants contend further that what was done here with respect to claims arising out of purchases of Grant securities before the class period was, for all practical purposes, what we condemned in *National Super Spuds, Inc. v. New York Mercantile Exchange*, 660 F.2d 9 (2 Cir. 1981). We disagree. in that case class certification had been ordered fairly early in the game; the class was limited to persons who had purchased May 1976 Maine Potato Future Contracts and were

damaged in liquidating such contracts between April 13, 1976, and the close of trading on May 7, 1976. The settlement, executed a year after notice of the certification had been sent and long after the opting out period had expired, purported to settle claims going beyond those asserted on behalf of this class and including the objector's claims for losses on contracts which were not liquidated on or before May 7, 1976, but on which he claimed to have suffered a loss thereafter. However, the proceeds of the settlement were to go solely to persons who had suffered losses on contracts which were liquidated on or before May 7, 1976.

The situation here is quite different. Before the class was certified, it was expanded to include persons holding state as well as federal claims. The notice sent to security holders clearly stated this and afforded an opportunity to opt out. Moreover, the settlement made provision for payments to holders of state claims although these were generally less than to holders of federal claims. We have no intention to depart in any way from *National Super Spuds;* we simply find it inapplicable to the facts here and hold, in agreement with other courts, that there is no rigid rule against the addition of new claims shortly before submission of a proposed settlement provided that proper notice and opportunity for opting out are afforded, see *Cherner v. Transitron Electronic Corp.*, 221 F.Supp. 48, 50 (D.Mass.1958); *Heddendorf v. Goldfine,* 167 F.Supp. 915, 921, 928 (D.Mass.1958); *Pergament v. Frazer,* 93 F.Supp. 13, 20 (E.D.Mich. 1950), *aff'd sub nom., Masterson v. Pergament,* 203 F.2d 315 (6 Cir.), *cert. denied,* 346 U.S. 832, 74 S.Ct. 33, 98 L.Ed. 355 (1953), and that the settlement fairly and adequately provides for the new claims. See also *National Super Spuds v. New York Mercantile Ex-*

*change, supra,* 660 F.2d at 18 n.7; *TBK Partners Ltd. v. Western Union Corp.,* 675 F.2d 456 (2nd Cir. 1982).

[14,15] In considering whether the settlement discriminated unfairly against the state versus the federal claims, we confront the reiterated contention by appellants that the state law fraud and breach of fiduciary duty claims faced less worrisome legal obstacles than did the federal securities law claims. Such a position runs counter to generally received learning. 5 Jacobs, Litigation and Practice under Rule 10b-5, §11.01, at 1-272 to 1-273 (1981) (footnotes omitted) ("it is now generally agreed that [rule] 10b-5 is procedurally more advantageous and substantively broader than the common law.") (citing cases); *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 495 F.2d 228, 239 (2 Cir. 1974) (citing cases). For example, the plaintiff's burden of proof in a common law fraud case—clear and convincing evidence—is more demanding than in a Rule 10b-5 case. *Rudman v. Cowles Communications, Inc.,* 30 N.Y.2d 1, 330 N.Y.S.2d 33, 280 N.E.2d 867 (1972); *Pierce v. Richard Ellis & Co.,* 62 Misc.2d 771, 773, 310 N.Y.S.2d 266, 269 (Civ. Ct. 1970); *Ajax Hardware Mfg. Corp. v. Industrial Plants Corp.,* 569 F.2d 181, 186 (2 Cir. 1977); 5 Jacobs, *supra,* at 1-277. Similarly, Rule 10b-5 is typically regarded as better suited than common law fraud principles for application to novel theories of securities frauds—which is admittedly the type of action involved in *Weinberger/Panzirer,* see, e.g., Frohling, The Promoter and Rule 10b-5; Basis for Accountability, 48 Cornell L.Q. 274, 290 (1963). The one element in which Rule 10b-5 is more rigorous against a plaintiff than New York law, which appellants assume would apply to the common law fraud claims, is its requirement that the fraud be "in connection with" the purchase or sale of a security, see *Blue Chip Stamps v.*

*Manor Drug Stores,* 421 U.S. 723, 730, 95 S.Ct. 1917, 1922, 44 L.Ed.2d 539 (1976), in contrast to the rule of New York law whereby persons who merely held Grant securities would have been permitted to show reliance by proving that defendants' alleged misrepresentations and nondisclosures caused them to hold securities they would otherwise have sold. *Continental Insurance Co. v. Mercadanta,* 222 A.D. 181, 225 N.Y.S. 488 (1927); 24 N.Y.Jur. Fraud and Deceit §165, at 233-34 (1962 & 1982 Supp.). This, however, simply shows which claims get into the federal basket, not that those that don't are more valuable than those that do. In the light of all this, we conclude that the common law fraud claims against the defendants were generally less valuable than the Rule 10b-5 claims of actual purchasers of Grant securities, and that it was not unfair for the settlement's distribution formula to reflect this.

[16] We are similarly unimpressed by the appellants' contentions as to the strength of their common law breach of fiduciary duty claims. Appellants make much of the point that under New York law the general rule that plaintiff has the burden of proving fraud is "somewhat relaxed in cases where a fiduciary relation exists between the parties to a transaction, and where one has a dominant and controlling force over the other", 24 N.Y. Jur. §278, at 360 (1962 & 1982 Supp.). Application of this principle ordinarily has been limited to relationships such as those between "guardian and ward, trustee and cestui que trust, attorney and client, and physician and patient", *id.,* with more recent extensions to relationships such as those between social worker and client, *Hector M. v. Commissioner of Social Services,* 102 Misc.2d 676, 425 N.Y.S.2d 199 (Family Ct. N.Y. City 1980) (ad hoc

application only), and nursing home and patient, *Gordon v. Bialystoker Center & Bikur Cholim, Inc.*, 45 N.Y.2d 692, 412 N.Y.S.2d 593, 385 N.E.2d 285 (1978). In order for the principle to apply plaintiffs must affirmatively show the existence of a fiduciary relationship between defendants and themselves, which requires judicial inquiry into the legitimate expectations of the parties and, more generally, the practical implications of recognition of a fiduciary relationship, 24 N.Y.Jur. §278 (1962 & 1982 Supp.); see *Diamond v. Oreamuno*, 24 N.Y.2d 494, 301 N.Y.S.2d 78, 248 N.E.2d 910 (1969); *Frigitemp Corp. v. Financial Dynamics Fund*, 524 F.2d 275, 278-79 (2 Cir. 1975). Plaintiffs would have faced serious difficulties in establishing the existence of a fiduciary relationship between a lending bank and the security holders of a borrowing corporation. While such a development is not beyond the realm of possibility, it would have required a significant extension of existing procedures. The fiduciary relation recognized in *Diamond v. Oreamuno, supra*—between a manager of a corporation and its shareholders—has been accorded such status for nearly a century. In contrast, appellants have cited us to no decisions in which a fiduciary relationship was found to exist between a bank and its borrower's security holders. Moreover, the extension of fiduciary principles to this relationship would face serious obstacles, such as arguments that lending relations between banks and large corporations are the product of arm's-length bargaining and that it would be anomalous to require a lender to act as a fiduciary for interests on the opposite side of the negotiating table.[16] Similarly, Bankruptcy Judge Galgay's findings that "the transaction between the Bank Claimants and Grant are the result of arms-length negotiations" and "the action taken by Grant

reflected independent policy decisions", 4 B.R. at 76-77, would cut strongly against the application of fiduciary principles to the banks in this case.

[17] Even assuming that the banks could be shown to stand in a fiduciary relation to Grant's security holders, the record indicates that neither they nor Peterkin, who as a director concededly was in such a relation, engaged in any wrong-doing. Indeed, as the above-quoted findings of Judge Galgay on the closely-related subject of equitable subordination show, see pp. 24-26, *supra*, there is virtually no evidence that the defendants engaged in any wrongdoing in their dealings with Grant. In light of all this, we agree with appellees that the state law claims were extremely weak and that the proposed settlement's treatment of such claims was fair and adequate, even though the fairness of the treatment of claims added on the eve of settlement is subject to especial scrutiny. Finally, as to the settlement's release of unasserted class claims arising out of the facts underlying the consolidated amended complaint, appellants have suggested no such claims, and we are aware of none, which would have had even the slight chance of success that the Rule 10b-5 and common law claims possessed.

D. *The Lack of an Evidentiary Hearing*

[18] We next deal with appellants' contention that the district court erred in refusing to conduct an evidentiary hearing preceded by additional discovery on the adequacy of the settlement. As the court below observed, counsel for appellants have had complete access to the extensive materials compiled in this litigation in the bankruptcy proceedings, and their

state court claim provided them with yet another route for discovery. Appellants appear to have done little to explore any of these options. In addition, they came forward with no specific objections to the substantive fairness of the settlement, and they have provided no specific criticisms of Judge Galgay's careful examination of the relationship between the banks and Grant. Moreover, aside from expressing a desire to cross-examine plaintiffs' counsel regarding their efforts in the litigation, appellants did not suggest what further efforts at discovery might be pursued.

On these facts we see no reason to require an evidentiary hearing preceded by discovery. The only objections raised by appellants which have required serious consideration deal with points of law. Given the adequacy of the existing record and the absence of cogent factual objections to the settlement, we do not see what purpose an evidentiary hearing would have served. As we said in *City of Detroit v. Grinnell Corp., supra*, 495 F.2d at 464:

> Although the parties reaching the settlement have the obligation to support their conclusion to the satisfaction of the District Court, once they have done so, they are not under any recurring obligation to take up their burden again and again *ad infinitum* unless the objectors have made a clear and specific showing that vital material was ignored by the District Court.

## III. Propriety of the Fee Award against Appellants

One other matter requires discussion. On February 13, 1981, five days before the scheduled February 18 fairness hearing, Mr. Brewer served subpoenas *duces tecum* on counsel for both plaintiffs and

defendants. The subpoena served on lead counsel for the banks, Davis Polk & Wardwell, sought production of "[a]ll documents and records . . . relating to the commencement, prosecution and settlement" of the *Weinberger/Panzirer* action, and listed ten categories of documents. Mr. Brewer claims that in a subsequent phone conversation with an attorney at Davis Polk he limited the scope of the subpoena; the attorney averred that even if Mr. Brewer's recollection was correct, he continued to seek production of an extremely wide range of materials, many of which he must have known to be privileged.

On February 17 Davis Polk applied for an order to show cause why an order quashing the subpoena and awarding Morgan Guaranty $1,800 in attorneys' fees and expenses should not be issued. Counsel for the plaintiffs also moved to quash the subpoena, but did not seek a fee award. Judge Duffy did not sign the Davis Polk order, but, in an endorsement on the application, stayed the subpoena. A copy of Judge Duffy's endorsement was delivered to Mr. Brewer on February 17, although it appears he was not then informed of Davis Polk's request for fees. At the February 18 fairness hearing, Judge Duffy briefly questioned Mr. Brewer as to why he had served the February 13 subpoenas. Not satisfied with Mr. Brewer's responses, he imposed two $2,500 fee awards against him, one to plaintiffs' attorneys, and the other to Davis Polk. These were later reduced to a single $1,800 award to Davis Polk.

Appellees argue that the award against Mr. Brewer was warranted because he acted "vexatiously both in issuing subpoenas seeking obviously privileged materials . . . and in doing so without having pro-

perly identified any client or having properly filed any objections." Mr. Brewer vigorously denies these charges, averring that "the subpoenas in question were issued by my office in good faith on my part and in the honest belief and expectation that the proceedings at the hearing on the fairness and adequacy of the proposed settlement would be evidentiary and adversary in nature." Brewer Affidavit ¶4. He stated that he intended to use the documents produced to attack the adequacy of plaintiffs' preparations for the case.

[19] "The general American rule governing allocation of the costs of litigation places the burden of counsel fees on each party . . . ." *Nemeroff v. Abelson*, 620 F.2d 339, 348 (2 Cir. 1980), *citing Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 247, 95 S.Ct. 1612, 1616, 44 L.Ed.2d 141 (1975). There is, however, an "exceptional power to shift fees where an action has been commenced or conducted 'in bad faith, vexatiously, wantonly or for oppressive reasons.' " *F.D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. 116, 129, 94 S.Ct. 2157, 2165, 40 L.Ed.2d 703 (1974); *Browning Debenture Holders' Committee v. DASA Corp.*, 560 F.2d 1078 (2 Cir. 1977). We have previously found that a procedural step such as the issuance of "dragnet subpoenas", *id.* at 1088-89, may constitute bad faith or vexatiousness. We have required, however, a high degree of specificity in the factual findings of lower courts when attorneys' fees are awarded on the basis of bad faith, *id.* at 1089, and that there be "clear evidence" that the challenged actions "are entirely without color and [are taken] for reasons of harassment or delay or for other improper purposes", *Nemeroff v. Abelson, supra*, 620 F.2d at 348, *quoting*

*Browning Debenture Holders' Committee v. DASA Corp., supra*, 560 F.2d at 1088. These requirements are a sound means of ensuring that persons with colorable claims will not be deterred from pursuing their rights by the fear of an award of attorneys' fees against them, see *id.* at 1088.

[20] The district court offered little by way of explanation for its fee award. At the February 18 fairness hearing, when the awards were initially imposed—even in favor of the plaintiffs who had not sought one—no reasons were stated. In a brief order of March 26, 1981, the court characterized the subpoenas as "on their face, grossly overbroad." The order also relied on the fact that "there were no objections" to the settlement in determining that the issuance of the subpoenas was improper.

The record does not support a finding that there was "clear evidence" of bad faith or vexatiousness. Mr. Brewer contends that he was expecting an evidentiary hearing to be held on February 18 and that he needed to have the documents in court, particularly since the affidavits supporting the settlement were not yet available. His phone conversation with Mr. Lewis narroing the scope of the document request was at least some evidence that he had not in fact been acting in bad faith in issuing the February 13 subpoenas. As noted previously, the judge erred with respect to the absence of any objections to the proposed settlement. Davis Polk contends that Mr. Brewer had no standing to be heard on February 18 since all his clients who had filed objections had withdrawn them. The judge did not so find and this is not plain to us. In short, while not applauding Mr. Brewer's conduct, we do not think it reached the level at which the sanction of a fee award would be justified.

The judgment approving the settlement is affirmed. The order imposing sanctions on Brewer is reversed. No costs.

## FURTHER ORDER ON PETITIONS FOR REHEARING

On September 10, 1982, we entered an unpublished order on petitions for rehearing and suggestions for rehearing in banc filed by both sets of appellants with respect to our opinion of July 14, 1982, slip opinions at 61, in which we affirmed an order of Judge Duffy, in the District Court for the Southern District of New York, approving the settlement of class actions brought by purchasers of W. T. Grant Co. securities alleging violations of federal and state securities law. We corrected a factual statement, slip opinions at 67, full paragraph, last sentence, in a manner stated therein. Beyond that we noted the contention made on behalf of the Coyne appellants that by affirming Judge Duffy's order approving the settlement despite his failure to render more than a cursory opinion, we had placed ourselves in conflict with *In re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106 (7 Cir.), *cert. denied sub nom. Oswald v. General Motors Corp.*, 444 U.S. 870 (1979), and *Girsh v. Jepson*, 521 F.2d 153 (3 Cir. 1975), and indeed had ignored the command of *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc., v. Anderson*, 390 U.S. 414 (1968). We stated that we had no intention of doing anything of the sort but rather had regarded this as a unique situation where, because of the careful and well-reasoned opinions of Bankruptcy Judge Galgay on closely related issues arising in the bankruptcy liquidation of Grant, the district judge could properly have considered himself relieved

of what would otherwise have been his obligation to make a detailed assessment of the settlement. See slip opinions at 74. However, because the point ha not been adequately brought to our attention, we had not sufficiently focused on the fact that Judge Galgay's findings and conclusions were being seriously attacked in an appeal in the Grant bankruptcy proceedings that would shortly reach this court. We therefore directed that argument on the appeal from the order of Judge Duffy affirming Bankruptcy Judge Galgay's order in the Grant bankruptcy proceedings (hereinafter the Cosoff and Miller appeals) be heard before this same panel and ordered that issuance of the mandate in this case be stayed pending further order of this court.

Because of the number of issues raised in the Cosoff and Miller appeals, the need to supplement the inadequate record that had been filed, and the fact that Judge Duffy had rested his approval in that case primarily on *res judicata*, disposition of those appeals has taken longer than we had anticipated. However, by decision filed today, *In re W.T. Grant Co.*, we have generally approved Judge Galgay's findings of fact and conclusions of law in his opinion of February 20, 1980, 4 B.R. 53, as supplemented by his order of June 23, 1981, approving the settlement with the subordinated debentureholders there at issue. Specifically, after examining the findings and conclusions submitted by counsel for the trustee in bankruptcy in that case, we have rejected the assertions made by attorney Brewer, both in that case and in this, that Judge Galgay had simply rubber-stamped the submissions of counsel for the trustee, a practice disapproved by *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 656-67 (1964). Taking note of that decision Judge

Galgay said he had adopted the trustee's proposed findings of fact where he had found no reason to do otherwise; however, he formulated his own discussion of the law of equitable subordination, the issue that is of particular moment here. In light of his opinion and our own examination of much of the evidence, we find that the chances of plaintiffs' establishing that the banks promoted a public belief in the viability of Grant which the banks did not share are extremely problematic.

We thus adhere to our opinion of July 14, 1982. In doing so we reaffirm the duty of district judges in this circuit to make a considered and detailed assessment of the reasonableness of proposed settlements of class actions, as held by the Third Circuit in *Girsh, supra*, 521 F.2d 153, 157-58, 159-60, and by the Seventh Circuit in *General Motors, supra*, 594 F.2d 1106, 1132 n. 44.

The factual correction made by our order of September 10, 1982, is further revised as follows: Strike last sentence of the full paragraph on p. 67 and substitute:

> Eleven bondholders appealed this order to the District Court for the Southern District of New York (Conner, J.), which stayed consideration of the appeals so that Bankruptcy Judge Galgay could supervise continuing negotiations among the bankruptcy trustee, the indenture trustee, the banks, and the debentureholders for an improved offer to the latter. Counsel for the debentureholders who had appealed from the order approving the earlier offer stipulated that these appeals be withdrawn with prejudice, and this was so ordered. On June 23, 1981, an amended offer was approved by Judge Galgay. Two groups of debentureholders ap-

pealed to the District Court (Duffy, J.) from the order approving the amended offer. In an opinion and order dated March 15, 1982, Judge Duffy affirmed the order, 20 B.R. 186. He rested his decision primarily on the ground of *res judicata*, although he also stated that the appeals were without merit. Two groups of debentureholders have appealed to this court.

The petitions for rehearing are thus granted insofar as concerns the correction of the factual statement but are otherwise denied. The clerk will appropriate steps with respect to appellants' suggestion for rehearing in banc. The stay of the mandate will be revoked if no judge in regular active service requests rehearing in banc or, if this is done, such a request is denied.

## FOOTNOTES

1. The principal lender to Grant was Morgan Guaranty Trust Company of New York (Morgan Guaranty), a wholly owned subsidiary of J. P. Morgan & Co., Inc. The banks named as defendants in the actions below, in addition to Morgan Guaranty are Citibank, N.A., The Sanwa Bank, Ltd., The Chase Manhattan Bank, N.A., Chemical Bank, Irving Trust Company, Marine Midland Bank, Bankers Trust Company, Manufacturers Hanover Trust Company and The Bank of New York. The settlement also applies to a number of other banks that had been major lenders to Grant, because the suits below were brought against Morgan Guaranty both individually and as agent for these banks and also because the loan agreements among the banks and Grant provide for the sharing of obligations and recoveries on the loans to Grant.

2. Federal securities and state common law claims asserted against a number of defendants, including certain

officers and directors of Grant and Grant's auditors, are not involved in the settlement. In addition, claims against Mr. Peterkin that do not relate to insider trading (Count III of the consolidated amended complaint) are not included in the settlement. Finally, the settlement does not affect claims against Chase Manhattan as Indenture Trustee for Grant's 4¾% Debentures, see note 8, *infra*, or claims asserted in Grant's bankruptcy proceedings on behalf of present debenture holders.

3. This was deposited in an interest-bearing account and by the date of oral argument had increased to approximately $3.5 million.

4. For example, the banks agreed to the granting of a senior security interest to Grant's vendors in early 1975, extended the maturity of the revolving credit agreement from June 2, 1975, to March 31, 1976, permitted the early repayment of loans due to a number of small banks, and subordinated payments of $300,000,000 of the outstanding bank loans to the payment of Grant's vendors. The last action was taken less than a month before Grant filed its Chapter XI petition. Naturally the objectors place a quite different interpretation upon those actions.

5. The Bankruptcy Court defined equitable subordination as requiring proof that "the claimant sought to be subordinated (a) has acted in a fiduciary capacity; (b) has breached a fiduciary duty; [and] (c) that breach resulted in detriment to those claimants to whom a duty was owed," *In re W. T Grant Co.*, 4 B.R. 53, 74 (Bkrtcy. N.Y. 1980). See *Pepper v. Litton*, 308 U.S. 295, 306-07, 60 S.Ct. 238, 245, 84 L.Ed. 281 (1939) ("The essence of the [equitable subordination] test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain.")

6. The trustee was assisted by the law firm of Weil, Gotshal & Manges and the accounting firm of Price Waterhouse & Co.

7. On March 20, 1976, Bankruptcy Judge Galgay ordered that various of Grant's business records be preserved and made available to counsel for the plaintiffs below; Grant's employees also were enjoined from disposing of or destroying any of these documents.

8. These were holders of Grant's 4¾% convertible subordinated debentures due 1996 ($92,507,000 face amount outstanding) and 4% convertible subordinated debentures due 1990 ($834,000 face amount outstanding). The settlement covered only claims of persons then holding the debentures.

9. Judge Duffy later extended the deadline for opting out as to states represented by Mr. Brewer whose pension funds had invested in Grant securities, but not as to other class members, until February 16, 1981.

10. In addition to the January 19 motion, a letter by Mr. Brewer to Judge Duffy dated September 16, 1980, with copies to counsel for the plaintiffs and for the defendants in the *Weinberger* action, clearly raised the objections as to the inclusion of state law claims not previously pleaded and as to the making of class determination only as incident to a settlement considered below. Objections which have been brought to the attention of the court and of counsel for proponents of a settlement by counsel for objectors should not be disregarded simply because they do not precisely comply with the procedures for the filing of individual objections specified in the notice of settlement. See 3 Newberg, Class Action §5660d (1977). In passing on settlements of class actions under F.R.Civ.P. 23 the judge should not regard himself as an umpire in typical adversary litigation. He sits also as a guardian for class members who have not received a notice or who lack the in-

tellectual or financial resources to press objections, *National Super Spuds v. New York Mercantile Exchange*, 660 F.2d 9, 20 (2nd Cir. 1981) (citing cases); *Mandujano v. Basic Vegetable Products, Inc.*, 541 F.2d 832, 834-36 (9 Cir. 1976). Here the judge evidently did consider all the objections, see 91 F.R.D. at 495 n.4 and the February 6 order, although erroneously believing he was not required to do so and accordingly not discussing many of them or doing so only conclusorily.

11. Appellants also argue that the notice was defective because it did not state what proportion of the class's total loss the settlement fund represented. Appellees meet this by noting that any estimate as to class losses—much less individual losses—would have been highly speculative and more likely to hinder informed decision-making by class members than advance it.

12. The Second Amended Complaint in *Lewy* served in March, 1979, named only Chase Manhattan, Morgan Guaranty and Citibank as defendants. The complaint, which relies on factual allegations almost identical to those in the consolidated amended complaint, asserts that the defendants "exercised dominance and control over the board of directors and management of Grant" ¶9. In addition, the complaint alleges that the defendants "conceal[ed] negative facts concerning the financial condition and unlawful mismanagement of Grant" thus effecting a manipulation of the securities market. ¶11. The complaint goes on to describe numerous acts allegedly committed in furtherance of defendants' conspiracy, dwelling principally upon those set out in the *Weinberger/Panzirer* papers. Like the consolidated amended complaint, the *Lewy* complaint asserts causes of action based on common law fraud, ¶1, and on breach of fiduciary duties, ¶¶1, 31. So far as we can tell, the *Lewy* action would require proof of fault identical to what would be demanded in the *Weinberger/Panzirer* cases.

13. Appellants also allege that the notice was "substantially incorrect and seriously isleading" in a number of respects, Appellants' Br. in No. 81-7829, at 19-21. The defects cited by appellants either do not exist—owing to misreadings by appellants' counsel of the notice or other publicly filed documents—or are immaterial.

14. The subsection provides, in pertinent part, that

> In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort.

15. Our holding regarding pendent party jurisdiction is also limited to the peculiar "alignment of parties and claims" involved here, namely, the joinder of plaintiffs in a *settlement* of an action involving Rule 10b-5 and state law claims. *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed. 2d 539 might be read as discerning a congressional intent to preclude the joinder of mere holders of securities in Rule 10b-5 cases in federal court, because of a desire to prevent disruption of the nation's businesses and to reduce vexatious litigation, 421 U.S. at 739-49, 95 S.Ct. at 1927-31. Whatever the strength of this argument as to claims that are proceeding to litigation, it surely is inapplicable when, as here, extension of pendent party jurisdiction permits the comprehensive settlement of plaintiffs' claims, thus furthering the policies underlying *Blue Chip Stamps.* We need not now decide how *Blue Chip Stamps* would affect the assertion of pendent plaintiff jurisdiction in a case not involving a settlement.

16. *Cf. Rader v. Boyd*, 252 F.2d 585, 587 (10 Cir. 1958) ("Parties may assuredly deal at arm's length for their mutual benefit without raising a confidential relationship between them.") In passing on a settlement we are "not to . . . resolve unsettled legal questions," *Carson v. American Brands Inc.*, 450 U.S. 79, 88 n.14, 101 S.Ct. 993, 998 n. 14, 67 L.Ed.2d 59 (1981), which a theory of recovery based on breach of fiduciary duty by the lenders surely would be.

## RULE 23 FRCP

**Rule 23. Class Actions.**

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class,

thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to Be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable ef-

fort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b)(1) or (b)(2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b)(3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c)(2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the

members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

## DOCKET ENTRIES IN U.S. COURT OF APPEALS FOR THE SECOND CIRCUIT

4/28/81—Copies of docket entries and notice of appeal on behalf of Brewer & Soeiro filed.

5/8/81—Copy of receipt of payment of docketing fee on behalf of Brewer & Soeiro filed.

5/8/81—Appellant Brewer & Soeiro Form C, pfs filed.
5/8/81—Appellant Brewer & Soeiro Form D, pfs filed.

5/12/81—Scheduling Order No. 1, PC filed.

6/1/81—Order withdrawing the appeal of Brewer & Soeiro and such motions, if any now pending without costs and without attorney's fees and without prejudice to whatever rights appellant has under law to appeal after entry of final judgment, filed. (JON). (on consent).

6/1/82—Issued certified copy of order withdrawing the appeal, etc.

6/9/81—Receipt of certified copy of order withdrawing the appeal received.

1/15/82—Record on appeal filed [& in 81-7629, 81-7827, & 81-7829].

1/20/82—Appellants Brewer & Soeiro notice of reinstatement of the appeal filed.

2/8/82—Scheduling Order No. 2 filed; further ordered that Appeals Docket Nos. 81-7827, 81-7829, 81-7629 & 81-7317 be and are hereby consolidated filed [& in 81-7827, 81-7829, 81-7629]

2/9/82—Supplemental record on appeal filed [copies of original papers filed in district court]

2/9/82—Appellants Coyne, Collins & 580 other named appellants brief filed [w/pfs] [& in 81-7827]

2/9/82—Appellants Lewy, Anderson, Barrie, Pine Lapham, Garson, Howe, Barnes & Johnson and Jurkiewicz brief filed [w/pfs]

2/9/82—Appellants Coyne, et al. joint appendix filed [w/pfs] [Volume I]

2/9/82—Appellants Coyne, et al. joint appendix filed [w/pfs] [Volume II]

3/3/82—Order granted, Appellants Coyne, et al. motion for leave to supplement the record on appeal with office copies of certain documents filed [LWP, CJ] [endorsed on motion for 1-29-82 filed in 81-7827]

3/8/82—Appellees Kendrick, et al., brief filed [w/pfs]

3/8/82—Appellees Weinberger, et al. brief filed [w/pfs]

3/22/82—Appellants Coyne, et al., reply brief filed [w/pfs] [& in 81-7827]

3/26/82—Appellants Coyne, Collins, et al., motion for an order adjourning the argument of this appeal filed; Appellants Coyne, Collins, et al., motion for an order consolidating this appeal with an appeal being taken from the S.D.N.Y. concerning the underlying bankruptcy proceeding filed [w/pfs] [& in 81-7827]

3/30/82—Appellees Weinberger, et al. affidavit in opposition to motion to delay this appeal filed [w/pfs]

3/31/82—Appellees Kendrick, et al. affidavit in opposition to motion for modification of order entered by staff counsel and for consolidation with proposed appeal in Cosoff v. Rodman filed [w/pfs]

4/1/82—Order denied, Appellants Coyne, Collins, et al., motion for an order adjourning the argument of this appeal filed; Order denied, Appellants Coyne, Collins, et al., motion for an order consolidating this appeal with an appeal being taken from the S.D.N.Y. concerning the underlying bankruptcy proceeding filed [TJM, CJ] [endorsed on motion of 3-26-82]

4/19/82—Case argued before: Waterman, Friendly & Meskill, CJJ

4/19/82—Appellant Lewy reply brief filed [w/pfs] [handed up in open court]

6/23/82—Second supplemental record on appeal filed (original papers of district court) (pursuant to Court's Request)

7/14/82—Order approving settlement affirmed; order awarding $1,800 in attorneys' fees against one of objectors' counsel reversed by published, signed opinion filed [HJF, CJ] [& in 81-7629, 81-7827 & 81-7828.

7/14/82—Judgment filed [& in 81-7629, 81-7827 & 81-7829]

7/27/82—Appellants Lewy, et al. petition for rehearing with suggestion for rehearing in banc filed [w/pfs]

7/29/82—Appellants Coyne, Collins & 580 other named appellants motion for leave to file a petition for rehearing with suggestion for rehearing in banc one day out of time filed [w/pfs] [& in 81-7827]

7/29/82—Appellants Coyne, Collins & 580 other named appellants petition for rehearing with suggestion for rehearing in banc *received* [& in 81-7827] (granted; 8/27/82; see motion, HJF)

8/27/82—Appellants Coyne, Collins & 580, etc. petition for rehearing with a suggestion for rehearing en banc filed, pfs.

9/1/82—Appellants Lewy et al. motion to file supplemental Petition for Reconsideration and suggestion for rehearing en banc, pfs filed. (Granted)

9/1/81—Appellants Lewy, et al petition for rehearing received.

9/10/82—Order on petitions for reconsideration; appellees are directed to file within 14 days a response to both petitions for rehearing. This shall include all issues raised in the petitions and should consider whether we ought not at least to direct the mandate be deferred until argument and decision of the appeal in the bankruptcy case and that that appeal should be heard before this panel.

9/10/82—Appellant Lewy supplemental petition for rehearing with suggestion for rehearing in banc filed (per 9/10/82 order)

9/10/82—Corrected order on petitions for reconsideration, etc., filed.

9/24/82—Appellant Weinberger response to petition for rehearing filed, pfs

9/24/82—Appellees J.P. Morgan et ano "appendix to response to petition for rehearing filed, pfs.

10/1/82—Order on petitions for reconsideration: Appellees in 81-7317, et al. having filed responses to the petitions for reconsideration as directed by our order of 9-10-82, it is order that: Oral arguement 8n docket nos. 82-5019 and 82-5023 shall be heard on November 9, 1982 at 2:00 p.m. before Judges Watreman, Friendly and Meskill. One half hour is allotted to each side, to be divided as counsel may agree; Counsel in the Weinberger appeals are directed to be present at the time of the foregoing argument in order to be available for any questions which the court may desire to ask; The mandate in the Weinberger appeals shall continue to be stayed pending the further order of this court. (HJF, TJM)

10/14/82—Appellant Coyne motion for leave to file a reply to reargument statements, pfs filed (*order endorsed: 10/14/82 granted; TJM*)

10/14/82—Appellee Weinberger affidavit in opposition to motion to appellant's motion pfs filed.

10/14/82—Appellants Coyne, Collins, et al., reply statement filed.

10/18/82—Appellant Lewy motion for leave to file reply statement to statements of appellees filed in con-

nection with petitions for reargument and en banc suggestion filed by appellants, pfs filed (order endorsed: 10/18/82 granted)

10/18/82—Appellant Lewy, et al., reply statement, pfs filed

1/26/83—Petitions for rehearing are thus granted insofar as concerns the correction of the factual statement but are otherwise denied, Published Signed Opinion.

2/22/83—Order denying Appellant Lewy petition for rehearing with suggestion for rehearing en banc, filed. (clerk)

3/2/83—Mandate Issued (Opinion, Judgment)

## OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK APPROVING THE PROPOSED SETTLEMENT OBJECTED TO BY PETITIONERS

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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WILLIAM B. WEINBERGER, et al.,
*Plaintiffs,*

-against-

JAMES C. KENDRICK, et al.,
*Defendants.*

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APPEARANCES:

WOLF POPPER ROSS WOLF & JONES
Attorneys for Plaintiffs
845 Third Avenue
New York, New York 10022
Of Counsel: Lester L. Levy, Esq.

-and-

WOLF HALDENSTEIN ADLER
FREEMAN & HERZ
Attorneys for Plaintiffs
270 Madison Avenue
New York, New York 10016
Of Counsel: Daniel W. Krasner, Esq.

DAVIS POLK & WARDWELL
Attorneys for Defendant
Morgan Guaranty Trust Company

of New York
1 Chase Manhattan Plaza
New York, New York 10005
Of Counsel: Philip C. Potter, Jr.
Ogden N. Lewis, Esq.
Laureen F. Bedell, Esq.

SHEARMAN & STERLING
Attorneys for Defendant
Citibank, N.A.
53 Wall Street
New York, New York 10005

MILBANK TWEED HADLEY & McCLOY
Attorneys for Defendant
The Chase Manhattan Bank, N.A.
1 Chase Manhattan Plaza
New York, New York 10005

HERTZOG CALAMARI & GLEASON,
Of Counsel to
Cravath Swaine & Moore
Attorneys for Defendants
Chemical Bank, Irving Trust Company,
Marine Midland Bank and Bankers Trust Company
100 Park Avenue
New York, New York 10017

SIMPSON THACHER & BARTLETT
Attorneys for Defendant
Manufacturers Hanover Trust Company
One Battery Park Plaza
New York, New York 10004

EMMET MARVIN & MARTIN
Attorneys for Defendant
The Bank of New York
48 Wall Street
New York, New York 10005

KEVIN THOMAS, D.J.:

On October 2, 1975, the W.T. Grant Company ["Grant"] filed a petition for bankruptcy under Chapter XI of the Bankruptcy Act. The next day certain purchasers of Grant securities instituted this class action claiming, *inter alia*, that defendant banks, [the "Banks"] and Morgan Guaranty, its corporate parent, J.P. Morgan & Co., Inc., and its former Vice-Chairman DeWitt Peterkin violated Section 10 of the Securities and Exchange Act of 1934 and Rule 10b-5 thereunder.

In essence, plaintiffs claimed that the Banks participated in a scheme to conceal from purchasers of Grant securities the allegedly far worse financial condition of Grant than was revealed to the investing public. Plaintiffs also asserted that Morgan Guaranty's Trust and Investment Division sold substantial holdings of Grant common stock on material inside information supplied by Mr. Peterkin.

The parties to this case have now reached a settlement [the "Settlement"] with respect to these claims and hereby submit it to this court for approval in accordance with Fed. R. Civ. P. 23. The proposed Settlement, in short, settles the fraud claims of purchasers and holders[1] of Grant securities against the Banks for alleged violations of the Exchange Act and Rule 10b-5 thereunder, as well as alleged violations of state

statutory law and common law fraud.[2] The Settlement also settles class members' insider trading claims against Morgan Guaranty, its corporate parent, J.P. Morgan & Co., Inc., and Mr. Peterkin.

The Settlement provides that the Banks pay $2,840,000 in settlement of these claims. This sum has been deposited by the Banks into an escrow account.

Notice of the class action determination, the proposed Settlement and dismissal of certain claims against the settling defendants was mailed in early December, 1980 to all persons who purchased or held Grant securities during the class period. Notice of the Settlement also was published in *The Wall Street Journal.*

Class members were also notifed about the hearing on the fairness of the proposed Settlement scheduled for February 18, 1981. Deadlines were set for class members to object to the terms of the Settlement or to exclude themselves from the Settlement.[3] Proof of claim forms were included with the notice.

No objections to the Settlement were timely filed.[4] The fairness hearing was held on February 18, 1981. At the hearing, certain plaintiffs' attorneys attempted to file late objections and asked the court to waive the deadline for filing such objections. This request was denied.

The rest of the parties present at the hearing submitted papers in support of the Settlement. I reserved judgment.

## Discussion

Rule 23 of the Federal Rules of Civil Procedure provides that a class action "shall not be dismissed or compromised without approval of the court." If fair, reasonable and adequate, however, the settlement of a class action should be approved. *City of Detroit v. Grinnell Corp.*, 356 F. Supp. 1380 (S.D.N.Y.), *aff'd in part, rev'd in part on other grounds,* 405 F.2d 448 (2d Cir. 1974).

In deciding whether a settlement is fair, the court must determine (i) whether the settlement was negotiated at arms length and in good faith; (ii) the probabilities of plaintiff's ultimate success or failure if settlement is not achieved; and (iii) the reasonableness of the amount offered in settlement.

The Settlement in this case satisfies each of these criteria. There is no indication that the Settlement was handled in a collusive manner. The settlement negotiations took place over a period of many months and were conducted by able and experienced counsel who are respected members of the bar of this court. I am confident that plaintiffs' attorneys have represented the class adequately and would not enter into any settlement agreement which would jeopardize the interests of the class.

Moreover, the decision to settle this case was based on extensive discovery conducted in connection with this case and in the related bankruptcy proceedings.[5] Counsel for all parties had full access to the record in this case and the bankruptcy record. I am satisfied, therefore, that the parties were fully able to evaluate the strengths and weaknesses of the class

claims against the defendants. In view of the findings of fact and conclusions of law entered by Bankruptcy Judge Galgay and the difficulties of proof present in this case, plaintiffs' conclusion that their chances of prevailing were slim was by no means an unreasonable one.

I also find that the sum offered in settlement by the defendants is fair considering the likelihood of plaintiffs' success on the merits. Plaintiffs' position with respect to each claim in this case is not so strong that settlement should be lightly rejected. Plaintiffs' claims against the defendants are complex and not easily proven. Indeed, plaintiffs have heavy burdens of proof with respect to each claim and the establishment of damages. Furthermore, the defendants have asserted vigorous defenses to each claim. Should the case proceed to trial, lengthy and costly litigation can be expected.

The reasonableness of the Settlement is further supported by the fact that the majority of counsel for the class members is recommending the acceptance of this Settlement. *See Philadelphia Housing Authority v. American Radiator & Standard Sanitary Corp.*, 322 F. supp. 834, 838 (E.D. Penn. 1971), *aff'd in part and modified in part*, 435 F.2d 30 (3d Cir. 1971). Finally, no objections to the Settlement have been filed by any members of the class.

In view of the difficulties plaintiffs would confront if this case went to trial, the recommendation of experienced counsel and the lack of individual objections to the Settlement, I find that the sum offered by the defendants is acceptable.

Accordingly, I hereby approve the Settlement as fair and reasonable. The claims against the settling defendants are dismissed with prejudice in accordance with the terms of the Settlement.

SO ORDERED.

Dated: New York, New York
August 13, 1981

s/Kevin Thomas Duffy, U.S.D.J.
KEVIN THOMAS DUFFY, U.S.D.J.

## FOOTNOTES

1. On July 29, 1980, I entered an order with respect to the class action determination and the hearing on the proposed settlement in this case. That order provided that the class was amended to include not only those persons who purchased but also those who held Grant securities during the period March 1, 1973 to October 2, 1975 inclusive.

2. On July 28, 1980, I approved the consolidation of *Weinberger v. Kendrick*, 75 Civ. 4870 (KTD) with *Panzirer v. Peterkin*, 77 Civ. 3462 (KTD). I also approved the filing of a consolidated amended complaint. That complaint included, in addition to the original claims, pendent state claims for breach of fiduciary duty.

3. The order filed on July 29, 1980, see note 1, *supra*, required class members who did not wish to be bound by the Settlement to request exclusion in writing from the Settlement not less than 25 days prior to the fairness hearing on February 18, 1981. Class members who did not wish to be excluded from the Settlement but wanted to file objections to it were required by the July 24, 1980 order to file them at least 14 days prior to the fairness hearing.

4. Certain plaintiffs' attorneys have attempted to file late objections. Not only were these objections late, they were also without merit. I, therefore, reaffirm my denial of the late filing of these objections.

5. *In re W. T. Grant Company,* Bankruptcy No. 75 B 1735.

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